FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2014

WEDNESDAY, MAY 8, 2013

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

The subcommittee met at 2:58 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Barbara A. Mikulski presiding.

Present: Senators Udall, Johanns, Moran, and Mikulski.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF HON. JACOB J. LEW, SECRETARY

OPENING STATEMENT OF SENATOR BARBARA A. MIKULSKI

Senator MIKULSKI. Good afternoon, everybody. The Subcommittee on Financial Services and General Government will come to order. Today the hearing will be about the Department of the Treasury's request for their fiscal year 2014 appropriations, and we will also take testimony from Acting Director Mr. Miller from the Internal Revenue Service (IRS), and we will also be listening to the Inspector General for the Department of the Treasury to give us ideas and recommendations on how we can improve the functioning of government, avoid any boondoggles, particularly in the area of technology, and also, though we're hearing particularly on IRS, we're not only going to talk about what are the best ways to collect the money, but also make sure we have a sense of frugality on how we spend the money. So we'll look forward to that.

I want to note that I'm kind of a pinch hitter today for Chairman Lautenberg as the chairman of the full committee, and he wants everyone to know that he's eager to begin work on this new bill. He could not be with us today and, rather than make the perfect the enemy of the good with Senator Lautenberg chairing himself, I said I would move this subcommittee forward.

Senator Johanns, I'd like to thank you as the ranking member for your courtesy here. I know that you also have to leave, so we're going to defer to you on some of the early bird questioning and really function in a bipartisan way.

We're going to have two panels, as I said, on both the Secretary of the Treasury and focusing on the IRS. As the Treasury Department's largest bureau, IRS accounts for one-half of this subcommittee's funding. We're so pleased that Secretary Lew could join us, and he's serving in a new role, in a crucial role at this very important time in our economy.

Secretary Lew knows better than anyone, after two tours of duty as the Office of Management and Budget Director, the importance of the appropriations process to create conditions that generate jobs today and grow our economy. That's why I support the President's budget level of $1.5 trillion, the same as we agreed to in the American Taxpayer Relief Act of 2013 that just passed 4 months ago. We know that there will be a difference of opinion with the House, who is marking up at the Ryan budget level of $966 billion. So there are going to be issues there. But right now the issue is to hear what does Treasury need and what it is that we need.

This week is Public Service Recognition Week, when we support public employees for their tireless work. The Treasury Department staff are on the job, providing value for the taxpayers. They do things like sanctions and the sanction experts at the Office of Foreign Asset Control target the sources of finances to disrupt Iran's pursuit of weapons of mass destruction.

They're the intelligence analysts at the Financial Crimes Enforcement Network, and they follow the financial paper trail to make sure that crime doesn't pay for terrorist financing, organized crime, or the narcotraffickers.

They're the payment specialists at the Financial Management Service (FMS) that ensure that Social Security benefits get to our seniors, taxpayers get their refunds, and benefits go to our disabled veterans.

We could go through agency after agency, and these agencies are on the job, serving America.

I am deeply troubled about what we face during the sequester. I am interested in the impact of the sequester both on the functioning of the Department of the Treasury—and Mr. Lew, we'll look to you for your commentary about it. I've heard it firsthand because I have world-class Treasury Department agencies in my State, from IRS to FMS and some other very important agencies.

PREPARED STATEMENTS

But we're also interested in what is the impact of the sequester as you see it on our economy and the failure to get our budget clear so that we could keep our economy on track. So we look forward to your commentary.

Senator Lautenberg has a statement which he has requested be made part of the record. His statement will follow mine.

[The statements follow:]

Prepared Statement of Senator Barbara A. Mikulski

Today, the Financial Services and General Government Subcommittee meets to examine the fiscal year 2014 budget request for the Department of the Treasury, including the Internal Revenue Service (IRS). Chairman Lautenberg is eager to begin work on his new bill, so I'm pleased to chair this hearing for him today, in order to get the process started.

We will have two panels today. Our first panel will be Treasury Secretary Jack Lew, while our second panel will focus on the IRS, which is the Treasury Department's largest bureau. The IRS accounts for one-half of this subcommittee's funding, so it's appropriate that we hear from Acting IRS Commissioner Steven Miller and Inspector General for Tax Administration Russell George.

We are so pleased Secretary Lew is serving in this new role, at this critical time. As we all know, we are in sequester now and unless sequester is canceled we will face sequester for the next 8 years. Secretary Lew knows better than anyone, and after two tours of duty as the Office of Management and Budget Director, he certainly knows the importance of the appropriations process to creating conditions that generate jobs and grow our economy.

That is why I support the President's budget request level of $1.058 trillion for discretionary programs, the same as the deal in the American Taxpayer Relief Act that passed the Senate 89–8 just 4 months ago. In contrast, the Ryan budget and the sequester level is $966 billion—this is $91 billion less than the President's request. In addition, the Ryan budget cancels sequester for the Department of Defense only, which means the entire $91 billion cut is from domestic spending. So we look forward to hearing from Secretary Lew about Treasury's own budget, the importance of supporting the President's budget request level, and the consequences of sequester—now and in the future.

This week is Public Service Recognition Week, when we salute public employees for their tireless work. Treasury staff are on the job providing value for the taxpayers, and I'll give just a couple of examples. Sanctions experts at the Office of Foreign Assets Control target sources of finance to disrupt Iran's pursuit of weapons of mass destruction. Intelligence analysts at the Financial Crimes Enforcement Network follow the financial paper trail to make sure crime doesn't pay for terrorist financiers, organized crime, and narcotics traffickers.

Payment specialists at the Financial Management Service ensure that Social Security payments get to our seniors, benefit payments get to our disabled veterans, and taxpayers get their refunds. Economists forecast economic indicators and track market conditions to monitor risks building up in our financial system. Specialists at the Alcohol and Tobacco Tax and Trade Bureau combat tobacco smuggling and tax evasion. Customer service representatives at the Internal Revenue Service answer questions so taxpayers complete their returns accurately.

To these employees and others throughout the government in these times of pay freezes and furloughs, I say we value your commitment and dedication and we thank you for your service to our country.

As Chairwoman of the full committee, I welcome the opportunity today to exercise the most important role of the Appropriations Committee: to conduct critical oversight of Federal spending. During these check-ups, we pursue these questions: What resources are needed to carry out critical missions, and are we getting value for the taxpayer dollar?

I want to have a candid discussion to determine where Treasury is today and where it needs to be in fiscal year 2014. To complement our oversight, a cadre of watchdogs and keen observers monitor and evaluate Treasury's operations, including: Treasury Inspector General; Treasury Inspector General for Tax Administration; National Taxpayer Advocate; IRS Oversight Board; U.S. Government Accountability Office; and, National Treasury Employees Union.

I appreciate the exemplary work and contributions of each of these entities. Their assessments help improve the work of the Treasury and the IRS. Chairman Lautenberg invited each organization to submit written materials to enrich the subcommittee's work and augment the hearing record. I ask unanimous consent that the statements and accompanying materials be made a part of the hearing record.

Treasury's total budget request is $14.2 billion, and the IRS accounts for $12.9 billion. For the remainder of Treasury operations the request is $1.3 billion for a wide variety of activities, from economic forecasting to combating terrorist financing and money laundering, and from community development financing to managing the books of the Federal Government.

I'm pleased that despite fiscal restraints, the budget maintains robust funding for the Community Development Financial Institutions Fund, or CDFI Fund. I'm also pleased that the request extends the CDFI Bond Guarantee Program, and will provide $1 billion in bond financing to CDFIs at no cost to the taxpayer. As our financial sector continues an unprecedented restructuring, CDFIs are playing a more critical role in making credit and financial services available in economically challenged communities.

I am concerned about the proposed 6-percent cut to Treasury's Financial Crimes Enforcement Network, which combats money laundering and terrorist financing by tracking the financial trail of criminals. I will want to learn more about why Treasury requests to reduce support for this critical agency.

The IRS has a dual mission: providing America's taxpayers with top quality service by helping them understand and meet their tax responsibilities, and applying the tax law with integrity and fairness to all. The IRS collects revenues that fund 92 percent of Federal operations and public services, and spending by the IRS is just 48 cents for every $100 collected in 2012. Each year, 89,500 IRS employees make hundreds of millions of contacts with taxpayers and businesses, representing the face of Government to more U.S. citizens than any other agency.

The President's budget requests $12.449 billion for the IRS, an increase of $656 million above the fiscal year 2013 funding, or 5.5 percent. Requested funding would provide:

—$5.42 billion for tax law enforcement, an increase of $132 million, or 2.5 percent;

—$2.41 billion for taxpayer services, an increase of $177 million, or 8 percent;

—$4.32 billion for operations support, an increase of $375 million, or 9 percent; and,

—$301 million for business systems modernization, a cut of $29 million, or 9 percent.

The request also includes $440 million to continue time-sensitive implementation of the Affordable Care Act, to establish infrastructure to help individuals buy healthcare on exchanges and assist public with questions on health insurance exchanges, tax credits. The request also includes $412 million for law enforcement activities to capture more delinquent revenue to reduce the deficit, but this is paid for in a way that exceeds our budget caps.

I look forward to hearing about the challenges that Treasury and the IRS face and how this subcommittee can be helpful in providing the right resources to support their critical missions.

PREPARED STATEMENT OF SENATOR FRANK R. LAUTENBERG

This is our first hearing of the fiscal year 2014 appropriations season for the Subcommittee on Financial Services and General Government. I am honored to serve as chairman of this subcommittee, which has jurisdiction over crucial Federal programs that support our economy, ensure fairness in the telecommunications industry, and protect consumers. One of our top priorities will be completing the work of Wall Street Reform Act by providing Federal regulators the resources they need to oversee the financial industry so that Main Street—and not only Wall Street—succeeds. I look forward to working with my colleagues and Ranking Member Mike Johanns to ensure these priorities are met.

Today, we examine the fiscal year 2014 budget requests for the Department of the Treasury and the Internal Revenue Service (IRS). These agencies manage many of the economic policies that are vital to our Nation's continued recovery from the Great Recession, ensure fairness by cracking down on tax cheats, oversee and intervene in the illicit tobacco trade, and enforce sanctions against rogue regimes, such as Iran. Each of these areas is of critical importance, and I believe Treasury and the IRS are vital to America's future prosperity.

It has now been 5 years since the beginning of the financial crisis that plunged this country into the worst recession it has experienced since the Great Depression. President Obama has led us out of recession, but too many Americans are still suffering. Though we are now consistently creating jobs, young workers and the long-term unemployed face major challenges in finding work. The economy is growing again, but increases in worker productivity have mostly led to increased corporate profits, while worker wages have remained stagnant. The housing market has stabilized and even begun to recover in some parts of the country.

Despite this progress, our recovery faces obstacles here in Washington. Republicans in the Congress continue to call for even deeper budget cuts—despite clear evidence that the austerity agenda they have championed has slowed the pace of job growth and needlessly increased the suffering of children, seniors, and middle-class families. These cuts could be avoided if we can come together on a reasonable proposal to raise revenue and stop protecting the wealthy.

In New Jersey, we still suffer from an unemployment rate of 9 percent—the seventh highest in the Nation. And homeowners in New Jersey remain under stress. With 7.3 percent of loans in foreclosure, New Jersey has the second highest foreclosure rate in America. The New Jersey HomeKeeper Program—which provides financial assistance to New Jerseyans facing foreclosure due to job or income loss—has been an important tool in keeping families in their homes. With my State's continued challenges and stubbornly high foreclosure rates, I call on the Treasury Department to redouble its efforts to ensure that New Jersey homeowners receive the help they need.

Two areas that are also critically important and under the Treasury Department's purview are illicit tobacco trafficking and evasion of tobacco taxes. The Alcohol and Tobacco Tax and Trade Bureau (TTB) is charged with stopping tax evasion and manipulation in the tobacco market. Treasury has estimated that up to $4.5 billion in revenue is potentially lost each year due to tobacco tax evasion. We need to bolster TTB so it has the ability to investigate and stop the illicit tobacco trade and collect the revenue we need.

In addition, the IRS needs sufficient resources to prevent tax evasion generally, an effort that brings in $6 in revenue for every $1 spent.

And when it comes to our international obligations, few are more important than enforcing sanctions on Iran to prevent its development of a nuclear weapon and to stop its support of terrorism. Although we have had a complete trade ban on Iran since 1995, a significant loophole existed that allowed the foreign subsidiaries of American companies to do business with Iran. After years of hard work, I was successful in getting this loophole closed last year. Treasury enforces these sanctions, which are crippling the Iranian regime's ability to transfer funds to its terrorist allies and further its nuclear ambitions. We must remain vigilant, and I look forward to working closely with the Treasury Department to ensure that it has the resources it needs to do just that.

The spending constraints mandated by the Budget Control Act of 2011 will make it difficult to fund all of our priorities this year. However, I will ensure that key programs at the Department of the Treasury and the IRS receive the support they need to strengthen the economy in New Jersey and across the country.

Senator MIKULSKI. With that, I'd like to turn to Senator Johanns for any comments that he'd like to make.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Madam Chairwoman, thank you very much. My comments will be relatively brief because, as indicated, I have to move on in about an hour.

But I did want to offer some opening comments. To all of the witnesses who are here today, we appreciate your attendance. Today marks my first hearing as the ranking member of the Financial Services and General Government Subcommittee. I do appreciate the opportunity to serve on the Appropriations Committee, given its important role in providing oversight over discretionary spending.

As we begin our review of the President's budget for fiscal year 2014, I will note that I am pleased, I'm glad the President acknowledged that two important entitlement programs, Social Security and Medicare, are in trouble and must be strengthened. To his credit, he has proposed adjusting the formula that is used to calculate Social Security and Medicare cost of living adjustments to more accurately reflect inflation rates. But that's just part of the equation.

I am disappointed this budget does not make the necessary strides to addressing our Nation's debt. Unfortunately, the budget's small move toward entitlement reform is overtaken by increased spending, added debt, higher taxes, and additionally the President's budget calls for dismantling the bipartisan spending reductions he signed into law as part of the 2011 Budget Control Act. This would leave less than $12 billion of annual deficit reduction, compared to this year's projected deficit of $845 billion.

So the task before us is significant, if not enormous. If the President really wants to stimulate the economy, I would recommend he reverse his record of increased spending and taxes. It just seems straightforward to me as a former mayor, council member, commissioner at the local level, and Governor that money left at home with hard-working Americans means more money exchanging hands on Main Street.

We have to reduce the deficit and forge a path to a balanced budget. To make any real progress toward reducing Government spending and ensuring the future solvency of Social Security and Medicare, we all must engage in a serious discussion about how to put entitlement programs on a sustainable path, not only for my generation, but for the generation behind us.

My hope is that the President's recognition of the unsustainable path of our entitlements is only a first step, one that will be followed by additional meaningful proposals and leadership.

There are willing partners. I myself am a member of the group of eight Senators who have been working for a long time on coming up with ideas to deal with the budget issues. As a member of this subcommittee and the Senate, I will continue my efforts to do all I can to be a part of the approach to balance the budget and rein in spending.

We do need to repeal costly mandates, lower taxes, increase regulatory transparency and accountability. Americans are looking for us to do the work here in Washington. We must work to promote sustainable economic growth. We do so through a tax code that recognizes that hard work and achievement are worthy of reward, not penalty, and by making difficult decisions necessary to put our country on a path to long-term financial security.

So as we review the budget request, I look forward to working with the chair and other members of the Committee and subcommittee to do our part to address the mounting financial issues and promote a stronger economy for our Nation.

Thank you, Madam Chairman.

Senator MIKULSKI. I want to welcome two of my colleagues: Senator Udall, who is new to the subcommittee, but not new to appropriations, excellent experience in the House; and our colleague Senator Moran.

What I would like to suggest is we go right to the Treasury Secretary. As you know, we had to change the schedule. Senator Johanns has to leave. Secretary Lew had to readjust. So I'd like to go right to him. Comments that you'd like to make include in your questions as we proceed.

Mr. Lew, I'm going to have you testify. Then, Senator Johanns, I will go to you, in case you have to leave, because we can hold down the fort. Then I'll go to my questions and we'll follow the regular order. Does that sound like a good way?

Senator JOHANNS. That sounds like a great way.

Senator MIKULSKI. Mr. Secretary.

SUMMARY STATEMENT OF JACOB J. LEW

Secretary LEW. Thank you very much, Chairwoman Mikulski, Ranking Member Johanns, members of the subcommittee. I appreciate this opportunity to speak about the Treasury budget. I'd just like to say that I'm sorry that my friend Senator Lautenberg isn't here today and I only wish him well and that he returns soon.

I want to start by thanking the talented public servants at the Department of the Treasury. They're thoughtful, dedicated, and focused. Their goal is to further the mission of the Department and the American people. It's really my honor to work with them.

I'd like to begin with an overview on the economy and then get into the Treasury budget. Our economy is much stronger today than it was 4 years ago, but we still need to continue to pursue policies that will help create jobs and accelerate growth. Since 2009, the economy has expanded for 15 consecutive quarters, private employers have added 6.8 million jobs, and the housing market has improved. Consumer spending, business investment are solid, and exports have expanded.

But very tough challenges remain. Families across the country are still struggling. Unemployment remains high. Economic growth needs to be faster. While we've made progress, we need to do more to put our fiscal house in order.

At the same time, political gridlock in Washington continues to generate a separate set of headwinds, including harsh, indiscriminate spending cuts from the sequester that will be a drag on our economy in the months ahead if they are not replaced with sensible deficit reduction policies.

The President has laid out a strategy to address these challenges. This path forward replaces sequestration and takes a balanced approach to restoring our Nation's long-term fiscal health. It makes important investments in manufacturing, infrastructure, and worker training. These investments are critical. They will help grow our economy and create jobs now and well into the future.

I was in Cleveland yesterday visiting with business owners and manufacturing workers, and it's absolutely clear the American people want us to focus our economy policies on growth and jobs.

Now, as our budget today demonstrates, Treasury helps shape and implement the President's economic policies, from streamlining the tax system and reforming the financial system to securing our interests abroad and increasing lending for small businesses at home. Whether it's making Social Security payments or producing our Nation's currency, Treasury touches the lives of almost every American. While our responsibilities are extensive, we're committed to meeting our obligations as efficiently as possible and at the lowest cost to the taxpayer.

Over the last 4 years, Treasury has made enormous progress to make the Department leaner and more efficient. Today we build on that momentum by identifying nearly $400 million in additional savings. In this budget we wring out wasteful spending and consolidate redundant programs. We cut travel costs and sharply reduce expenses. We use materials more effectively at the Bureau of Engraving and Printing. We save on rent at the Bureau of Fiscal Services, and we provide more of our services electronically so we can continue to cut down on paper and paperwork.

In total, we're reducing spending by 2.3 percent when you exclude the IRS and compare this year's budget to what was provided during the past fiscal year. The IRS is the main area where we're requesting an increase. These additional resources will, with the program integrity cap adjustment, allow the IRS to improve enforcement. With this new funding, the IRS will crack down on those who are evading the law and bring in more revenue. For every $1 we spend on our enforcement initiatives, we expect to collect $6 in revenue.

The request for an increase also includes additional funding so that the IRS can meet its responsibilities under the healthcare law, which lowers the forecast budget deficits by more than $1 trillion over the next two decades. The Affordable Care Act (ACA) is helping to slow the growth of healthcare costs and continued implementation of ACA will help to improve the quality and efficiency of our healthcare system.

Nevertheless, in order for the IRS to carry out its obligations as mandated by the Congress under the healthcare law, it needs the appropriate resources. Beginning in 2014, millions of Americans will receive unprecedented tax benefits that will make buying health insurance affordable. The IRS must have the necessary funding to assist Americans as important provisions of the law go into effect.

For example, the IRS must invest in new technology and modify existing IRS tax administrative systems. These efforts will facilitate prompt and accurate application of the premium tax credits while protecting taxpayer information.

I'd like to point out that sequestration has taken a toll on Treasury, but we are doing everything we can to absorb these cuts before reducing services. We have scaled back training, delayed contracts, and limited purchases. But even with these measures, the brunt of the cuts is being felt by Treasury's hard-working public servants. At the IRS, for example, workers will have to stay at home without pay for as many as 7 days between now and September. This will erode our ability to provide quality service by forcing the IRS to answer fewer calls and creating unexpected and unwanted delays in responding to taxpayer questions. It will also lead to fewer enforcement actions and reduced revenue collection.

PREPARED STATEMENT

The fact is the sequester is not only hurting Treasury's employees, it's hurting taxpayers as well. As I've said before, sequestration must be replaced as soon as possible. The President's budget does that, and I hope this subcommittee and your colleagues will take action so we can get this done.

With that, I thank you, and I look forward to answering any questions that you have.

[The statement follows:]

PREPARED STATEMENT OF HON. JACOB J. LEW

Chairman Lautenberg, Ranking Member Johanns, and members of the subcommittee, thank you for giving me the opportunity to speak about the Treasury budget.

I would like to turn to the current state of economic conditions.

The U.S. economy has made substantial progress toward recovering from the worst financial crisis since the Great Depression. Despite significant headwinds—both as a result of the crisis and from other temporary shocks—the economy has grown at an average annual rate of just more than 2 percent over the last 3½ years. We have seen steady improvement in the labor market, where private sector employers have added 6.8 million jobs since the trough of the labor market in February 2010. The housing market, which had been a significant drag on economic growth throughout the recession and into the early stages of the recovery, is now gaining upward momentum.

While our economy is stronger today, more work must be done to help create jobs and accelerate growth. Even though the unemployment rate, at 7.5 percent, is at its lowest level in 4 years, it is still too high. Too many Americans are still struggling to find work. Despite recent improvements in the housing market, many families remain underwater on their mortgages and credit-worthy borrowers continue to have trouble getting the financing they need to buy homes or refinance existing mortgages. Although corporate profits are at an all-time high, America's middle class continues to struggle.

The President has laid out a strategy to address these challenges. His path forward strengthens the economic recovery by making important investments in manufacturing, innovation, infrastructure, education, and worker training while taking a balanced approach to bringing our deficits down to a sustainable level. This balanced approach includes entitlement reform, targeted spending cuts, and increased revenue through tax reform. And it is based on the conviction that we can both get our fiscal house in order and lay a foundation for long-term growth at the same time. We do not have to choose one over the other.

Treasury plays a vital role in helping to shape and implement the President's economic policies, promoting a carefully balanced fiscal policy, driving reform of the financial system, encouraging lending to small businesses, working to reform the tax system, promoting economic prosperity, and monitoring risk in the financial system.

It is important to note that Treasury continues to implement the comprehensive financial reforms included in the Dodd-Frank Act. These reforms place tougher limits on risk-taking by financial institutions in order to stabilize the financial system and protect American taxpayers. Our financial institutions have boosted their level and quality of capital and are stronger and more stable than before the crisis. These developments have made our financial system safer and stronger and better able to support lending and economic growth.

We are also supporting small business growth through our Small Business Lending Fund (SBLF) and State Small Business Credit Initiative (SSBCI). As of September 30, 2012, SBLF participants have increased their small business lending by $7.4 billion over a $36.5 billion baseline and by $740 million more than the prior quarter. In 2012, Treasury approved $137 million for disbursement to States under the SSBCI. Treasury estimates disbursing cumulative totals of approximately $1.1 billion by the end of fiscal year 2013 and the remaining $360 million by the end of fiscal year 2014.

Treasury's fiscal year 2014 budget supports the President's strategy to meet our economic and fiscal goals by focusing on key priorities that will strengthen growth and lower costs to the taxpayer. Our budget does this by reducing waste, increasing efficiency, and making investments to accomplish our core missions and achieve future savings.

Our request includes substantial investments in improved taxpayer service and enforcement and in technology at the Internal Revenue Service (IRS), which will drive efficiencies in the future. The proposal also reflects Treasury's contribution to protect our national security interests and prevent illicit use of the financial system.

IMPROVING EFFICIENCY, REDUCING TAXPAYER COSTS, AND STREAMLINING OPERATIONS

The fiscal year 2014 Treasury budget reflects a decrease of 2.3 percent from fiscal year 2012 enacted levels, excluding the IRS. The request for the IRS includes a $1 billion increase, of which $412 million is financed by a program integrity cap adjustment for enforcement initiatives that provide a high return on investment. This cap adjustment, which also includes $5 million for enforcement activities at the Alcohol and Tobacco Tax and Trade Bureau (TTB), funds strategic investments that will help close the tax gap and will return $6 for every $1 invested, once fully implemented. The proposed cap adjustment will yield more than $32 billion in net savings to reduce the deficit over the next 10 years.

Treasury's request also includes funding for initiatives that are critical to full and effective IRS implementation of the Affordable Care Act (ACA), which lowers the forecast budget deficit by more than $1 trillion over the next two decades. The ACA is helping to slow the growth of healthcare costs, and continued implementation of the ACA will improve the quality and efficiency of the healthcare system. Nevertheless, in order for the IRS to carry out its obligations as mandated by the Congress under the healthcare law, it needs the appropriate resources. Beginning in 2014, millions of Americans will receive unprecedented tax benefits that will make buying health insurance affordable. The IRS must have the necessary funding to assist Americans as important provisions of the law go into effect. For instance, the IRS must invest in new technology and modify existing IRS tax administration systems. These efforts will facilitate prompt and accurate application of the premium tax credits while protecting taxpayer information.

The sequester has taken a toll on Treasury, but we are doing everything we can to absorb these cuts without reducing services. We have scaled back training, delayed contracts, and limited purchases. Even with these measures, the brunt of the cuts is being felt by Treasury's hard-working public servants. At the IRS, workers will have to stay at home without pay for as many as 7 days between now and September. The fiscal year 2013 IRS operating plan is almost $1 billion less than the fiscal year 2011 enacted level, and as a result, the IRS has 8,000 fewer full-time employees than just 2 years ago. Sequestration hurts not only Treasury employees, but taxpayers as well. The cuts imposed by sequestration erode our ability to provide quality service by forcing the IRS to answer fewer calls and creating unexpected delayed in responding to taxpayer questions. It will also lead to fewer enforcement actions and reduced revenue collection.

The Treasury budget builds on our commitment over the past 4 years to deliver core services more efficiently and at a lower cost to the taxpayer. Our request identifies $354 million in efficiency savings and $29 million in program reductions.

Key savings proposals include space optimization and infrastructure efficiencies for the IRS, manufacturing support systems and spoilage reduction for the Bureau of Engraving and Printing (BEP), rent and data center savings for the Bureau of the Fiscal Service, and numerous administrative and personnel efficiencies across multiple bureaus.

We are also continuing to achieve savings from our ongoing paperless initiative. Treasury has implemented a multi-pronged effort to expand the use of electronic transactions in conducting the business of government, including through electronic payroll savings bonds, electronic benefit payments, and electronic tax collection.

Treasury's paperless initiatives are estimated to save $500 million over the 5 years from fiscal year 2011 to fiscal year 2015. In addition to these savings, our efforts have resulted in improved customer service and decreased susceptibility to fraud. The IRS's e-file program has proven highly successful, saving the Department millions of dollars every year. For example, in 2012, it cost 23 cents to process an e-filed return—a fraction of the $3.36 it takes to process a paper return. With e-file, taxpayers get their refund faster, with fewer data processing errors. The individual e-file rate is now more than 80 percent.

In fiscal year 2014, Treasury will implement a number of initiatives to improve operational efficiency and effectiveness across government. For example, Treasury is continuing to consolidate its two fiscal bureaus to create a stronger, more effective and efficient fiscal service organization that can take the lead in improving financial management throughout the government. The consolidation will also save up to approximately $96 million over 10 years. In addition, we are pleased that the Government Accountability Office (GAO) has recognized our progress improving the management of IRS information technology by removing our Business Systems Modernization from their high-risk list this year.

The fiscal year 2014 budget also includes additional funding for the Office of Financial Innovation and Transformation (FIT), which is working in coordination with the Government-wide CFO Council to improve financial management, reduce costs, increase transparency, and improve delivery of agencies' missions within Treasury and across the Federal Government. Treasury also proposes to transfer FIT from the Departmental Offices to the Bureau of the Fiscal Service to allow closer collaboration with the bureau that most closely aligns with its mission.

The budget also includes resources to administer the Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act of 2012 (RESTORE Act), which established the Gulf Coast Restoration Trust Fund to provide for the economic and environmental restoration of the gulf region after the Deepwater Horizon Spill. Treasury will serve administrative, compliance, and audit roles to ensure that funds are disbursed as required by the RESTORE Act.

Under the leadership of my predecessor, Treasury demonstrated creativity and resolve to find the most efficient ways to accomplish the important work that we do to serve the American public. As Secretary, I will make sure the efforts to reduce costs and increase effectiveness continue across the Department.

INVESTING IN ECONOMIC GROWTH AND JOB CREATION

Treasury supports economic growth for local communities and small businesses by funding projects that encourage job creation, attract investment, and increase financial access and capability.

Our $225 million request for the Community Development Financial Institutions (CDFI) Fund focuses on providing funding to promote economic development investments in low-income and underserved communities. Up to $35 million of that request will go to the Healthy Food Financing Initiative (HFFI), which will support increased availability of affordable, healthy food alternatives in these communities.

The budget requests $300 million in capped mandatory funding for Pay for Success, a new program that will reward nonprofits and other groups that finance preventive social programs that create savings for the Federal Government while achieving better outcomes for their target populations.

The budget also proposes $5 million for the new Financial Capability Innovation initiative, which will help low- and moderate-income people get the support and services they need so they can save more and manage their finances more effectively.

The Treasury budget includes $3 million for research and evaluation efforts that will allow us to make better budget and policy decisions on programs designed to encourage economic growth and opportunity.

PROTECTING OUR NATIONAL SECURITY INTERESTS AND PREVENTING ILLICIT USE OF THE FINANCIAL SYSTEM

Treasury's financial intelligence and enforcement activities play a significant role in protecting our financial system from threats to our national security. Our funding request for the Office of Terrorism and Financial Intelligence (TFI) reflects our continued efforts to target rogue nations, terrorist facilitators, transnational criminals, money laundering, and other threats to our financial system and our Nation's security.

Treasury has led the administration's efforts in isolating Iran from the global economy and cutting off vital sources of revenue that could be used to support Iran's nuclear program and support for terrorism. This work has resulted in what is now widely regarded as the toughest sanctions regime in history.

CONCLUSION

The fiscal year 2014 Treasury budget reflects a careful balance of savings proposals and targeted investments.

The proposed savings will be achieved through a combination of efficiency improvements and increased streamlining of operational processes, making Treasury a stronger organization that continues to provide indispensable services across the country efficiently and effectively. Our investments are aimed at reaching goals we all share: an economy that is expanding, a private sector that is robust, and a job market that is full of opportunities.

Treasury's work is carried out by a team of public servants that I am proud to represent here today. And on behalf of those hard-working men and women, I want to say how much we appreciate the support of this subcommittee over the past several years.

Senator MIKULSKI. Senator Johanns.

Senator JOHANNS. Thank you, Madam Chair.

Secretary Lew, thank you for being here again. Let me, if I might, focus some questions on a piece of legislation that was passed a year or so ago, Dodd-Frank, which you are very familiar with. I'd like to revisit a question that was posed to you about 1 month ago, and it was posed in a very bipartisan way. Senator Tester and I wrote to you.

DODD-FRANK AND SYSTEMIC RISK

You are the chair of Financial Stability Oversight Council (FSOC) and the question is this. What metrics is FSOC using to determine which nonbank companies are designated systemically risky? For me it seems like a very important question because those entities that are going to be hugely impacted by this designation should know where the lines are. So I'd just like to pose to you again what those metrics are and whether you think it's important for those metrics to be public?

Secretary LEW. Well, Senator, the general approach is something that is public. We're looking at whether or not there's a risk to the financial system, and that really amounts to a question of a combination of factors, including what the nature of the institution is, the size, the scope, the transmission mechanisms, that would indicate whether or not, if there were a financial problem with those firms, there would be contagion in other parts of the financial system.

The individual analyses that are going on are matters that are being discussed with the companies, but we haven't disclosed a public list of the companies and I don't think that would be appropriate unless and until designations are made, after which point in time those companies would have the ability to exercise any concerns they have in the review of those regulations—of those actions.

So I think there is going to be every opportunity for the FSOC to make a determination, to put forward the analysis, and then for that analysis to be reviewed.

Senator JOHANNS. I don't want to get stuck on this, although it's a hugely important issue. But as a former Cabinet member myself who regulated industries, it seems to me extremely important that you be able to say to the industry: This is what qualified you to be regulated, this is what excludes you from that regulation. I kind of look at this in the same way. It seems to me fair to just alert people out there, companies, whoever: This is why you're going to fall into this kind of hyper-regulation under Dodd-Frank.

What am I missing here?

Secretary LEW. Well, I think that the designations are still being reviewed. So to the extent that there are nonbank designations in areas where we've not yet taken action, there is not yet a public record to review. If actions are taken there will be a public record to review, and it will be very much substantiated by consistent analytics that get at the question of the scope of risk and the risk—whether or not the risk would spread. And there's a great deal of attention being given to making certain that those questions are being asked in a systematic way.

We're in the early stages of implementing a lot of Dodd-Frank. The FSOC is a new entity. This bringing together part regulators to make decisions like this is something that is being exercised for the first time. So it's difficult to have a long history of experience to go back on.

But I can tell you that as chair of FSOC I am very much focused on making sure that there is a kind of procedural regularity about the way it's being reviewed, so that there is consistent analysis that when it's reviewed it can withstand scrutiny.

So I would look forward as, assuming designations are made, going forward being able to demonstrate that by the actions.

Senator JOHANNS. If I might just wrap that up by saying I also serve on the Banking Committee. We spent hours in hearings trying to come to grips with this concept of systemic risk and what to do about it. So whatever brain power you can put behind it and as much transparency as possible is very critical. I'm confident in saying that's what we were driving toward as members of the Banking Committee.

DODD-FRANK AND SWAPS PUSHOUT

Let me, if I might, staying on the same piece of legislation: Chairman Bernanke testified in front of both the Senate Banking

Committee and the House Financial Services Committee that Dodd-Frank section 716 does nothing to make banks safer and it only increases the cost of using derivatives for end users; it's an end user issue; and that it should be fixed. His testimony was very clear on that.

Do you agree with that? I think there's a willing group of Republicans and Democrats saying we've got to do something on this. I've been working on this since the passage of Dodd-Frank, although I'm not—I wasn't a supporter of Dodd-Frank. Congressman Frank supports it, Sheila Bair, Paul Volcker, others. Do you agree that we need to fix this?

Secretary LEW. Senator, I think that we're still in the process of seeing how these issues are addressed by the regulatory agencies. The Fed still has some rules in this area that are not yet completed. I think there are questions about end users. The definition of "end users" is always a challenging one.

But I think we have to see where they end up in order to come back then and see whether it addresses the concerns that have been raised.

Senator JOHANNS. I'll wrap up with this because I'm out of time and I don't want to dominate the questioning here. But Senator Tester and I have been working on this. Again, I think we're trying to be very fair, very bipartisan about this. This is not a gotcha sort of thing. We just see some problems that we'd like resolved.

If you could send your staff in our direction, we'd be happy to lay out for you our thinking and what we're proposing to try to deal with these issues.

Secretary LEW. I'd be happy to have our staff follow up, Senator. I think there are legitimate questions for a firm that is trying to just run its business and have its process fuel on site. But the line between taking care of your regular business and speculating is a thin one and I would like to see where the regulators end up before reaching a determination as to whether or not there's any need for further corrective action.

Senator JOHANNS. Thank you, Madam Chair.

IMPACTS OF SEQUESTRATION

Senator MIKULSKI. Mr. Lew, you have a big agency and a very, very complex agency. Looking at this year's appropriations, we see that for Treasury if we take out IRS, which is the biggest agency under your umbrella of agencies, because the Treasury Department is really an umbrella function of very key functions, that the request is to fund you at $1.35 billion. That is what you're funded in the fiscal year 2013 continuing resolution omnibus.

This is nearly identical to the fiscal year 2012 enacted level. Now, under the sequester you're cut $66 million; am I correct in that?

Secretary LEW. I believe that's correct.

Senator MIKULSKI. Well, it's roughly, more or less, $66 million. My question to you, with all of the issues that you have to deal with in Treasury, from moving on a new framework related to Dodd-Frank, those other things that we ask you to do, to help the President formulate the fiscal policy, promote economic growth, promote exports, our currency, all of these very complex issues, along with implementing sanctions, which this Congress heartily supports, particularly our stunning success with Iran sanctions, to things at the local community that are near and dear to my heart and I know to Senator Lautenberg's, the Community Development Financial Institutions (CDFI) that have transformed neighborhoods.

My question to you, sir, is what is the impact of the sequester on the functioning of your agency? Is it a benign impact or a draconian impact? What is the impact of the sequester?

Secretary LEW. Senator, it is a very real impact. I already mentioned some of the impacts in the IRS. I think it's a very significant thing if taxpayers are inconvenienced by having difficulty reaching an office to get the assistance and advice that taxpayer assistance offices are meant to provide.

I spent a lot of years in Government trying to shorten waiting periods and improve the service that taxpayers and citizens get when they reach the Government. If waiting periods get longer and if questions don't get answered, I don't know how you measure the cumulative impact, but for every person who's kept on hold for 15 minutes or half an hour or doesn't get a clear answer that's a taxpayer who hasn't been well served. For every dollar we don't raise in revenue that should have properly been paid, but because we didn't have an enforcement officer—it's just, it's key to our tax system that we enforce the law and we enforce it as best we can.

On the program side, there are real impacts in terms of the direct services we provide. Our Build America bonds are being—the benefit is being reduced. Our Closed-End Fund grants, the benefit is being reduced. Those are helping build our communities. They're providing financing for important infrastructure projects.

These are the kinds of things that I don't think we would have chosen to cut. But because sequestration is across the board and it treats everything equally, they all get cut.

I don't think that there's any way to have flexibility to fix the problems at an agency like Treasury or the other agencies of Government. I think that it's just shifting around reductions after years of having tightened our belts. I think that the challenge going forward is going to be to replace across-the-board cuts with a sensible policy which is balanced between revenue and spending cuts, and I think there should be some entitlement savings in a balanced package, where we solve the medium and long-term problem.

Something that's not specific to Treasury, but I think all of us should worry about, is cumulatively sequestration is going to reduce our economic growth by a one-half a percent or more of gross domestic product (GDP). That translates into 750,000 full-time job equivalents across our economy. Right now our economy is growing, but not as fast as we would like. If I could sit here today and testify for some other way to increase economic growth by a one-half a percent of GDP and to create 750,000 jobs, people would think that was really important.

Well, the sequester takes that away from us. We could get the benefit of a one-half a percent of GDP growth and 750,000 jobs by replacing sequestration with a sensible medium and long-term policy, which is why the President put some very tough things in his budget as an alternative to sequestration.

Senator MIKULSKI. So first it will have—the sequester has a big impact on the functioning of your agencies. In your appropriations, the bulk of the request for Treasury is $12.861 billion for IRS. With the functioning of headquarters, the implementation of the sanctions, the financial crime, other, FMS, important agencies, it's $1.316 billion.

My point is this. You're saying that because what we're doing with the sequester in our Government, whether it's at Treasury, whether it's the Department of Defense (DOD), the big impact on contractors and civilians, to the National Institutes of Health, the future thinking of cures, exports and medical devices and pharmaceuticals that we can sell around the world and can end misery—are you saying that we're not only sequestering employees, but it's having a draconian impact on our economy? Is that right?

Secretary LEW. It's absolutely having an effect on our economy.

Senator MIKULSKI. Could you give us a sense of—you've now been in Europe, where they've gone austerity big time, "A" with a capital "A", whether it's the French or whatever. What is your view of an approach to both the sequester and our economy—and not to be critical of other governments and their policies, but the consequences. It might have lowered some public debt, but where has it left them in terms of their economy?

Secretary LEW. Well, I think before you even get to sequestration, the decisions that the United States made in 2009 to take immediate action to deal with getting our economy growing after a deep, deep recession, to fix a financial system that was in collapse, our economy is back on its feet, not growing as fast as we would like, but we're growing.

Europe took a different tack. They started with austerity, and their economies are not in general growing very well. Now, I don't think we disagree fundamentally that there needs to be deficit reduction in the medium and long term and we can't have deficits growing infinitely to dangerous levels. But when your economy is weak, you can't cut your way to growth. You have to get growth going and make the cuts when you can afford to absorb the cuts in the economy.

On the sequestration, this is not a time when as just an economic matter putting $50 billion or $100 billion of drag on the economy is a good idea. I think we need to get growth up to a level where we're seeing the benefits of growth in terms of higher incomes, therefore higher revenues, and lower spending because people are working and they're not drawing as much benefits, and have the savings kick in when the economy can bear it.

I also think that if we take a long-term view, cutting discretionary spending is very shortsighted at this point. We've made big cuts in discretionary spending. In 2011 we agreed collectively to cut more than $1 trillion dollars from discretionary spending over 10 years. So the caps that we're working with are already very tight. And to take the caps down below that means you're doing things that I don't think we would choose to do if we were looking at the policies not in an abstract way.

I don't think you could find a lot of either elected or appointed officials who want to cut cancer research. But that's what you do when you reduce the caps the way we have.

Senator MIKULSKI. Senator Moran.

Senator MORAN. Madam Chair, thank you very much.

I was on this subcommittee for the last 2 years and I'm glad to be back. It has important jurisdiction.

Mr. Secretary, congratulations on your nomination and confirmation.

Secretary LEW. Thank you.

Senator MORAN. Madam Chair, pleased to be with you, hope Senator Lautenberg is able to return to the Senate in the near future.

FINANCIAL REGULATORY REFORMS AND COMMUNITY BANKS

Let me first start on this issue of growing the economy. One of the things I think that Treasury could do, along with other regulatory agencies, is to assist our community banks and other financial institutions in the regulatory environment they face. Senator Johanns focused on some of our largest institutions. As a Kansan, we pay a lot of attention to community banks, credit unions, and their ability to make loans.

I am absolutely convinced, based upon the conversations I had with bankers, but also their potential borrowers, that the regulatory environment is handicapping the ability to make good solid loans to people within a community because of the regulatory concerns. I have a number of bankers who told me they no longer make home loans, real estate loans to people within their own community, because of the onerous nature and potential penalties for making an error.

Then beyond that, the increased regulatory cost is reducing the number of community banks that we have. The necessity of growing your bank, acquiring more banks in other communities—you have to have a significant increase in the number of depositors and loans in order to cover the increasing costs of hiring the people to comply with the rules and regulations.

I'm interested in knowing whether or not you as the Secretary of the Treasury have thoughts about how we can unleash the opportunities that banks have to make loans in communities across our country, but particularly in rural communities, and community banks?

Secretary LEW. Senator, I've met with community bank representatives and actual community bankers, even in the 8 or 9 weeks that I've been at Treasury. I've been trying very hard to listen to them as they describe to me what they've described to you. I guess I would make a few observations.

First, both the laws that have been enacted and the rules as they're being implemented are taking cognizance of the concerns of smaller financial institutions. I think one of the challenges we have in general is that there was a delay in the implementation of certain provisions of Dodd-Frank, frankly because it was still a political debate as to whether or not Dodd-Frank was going to be implemented or whether it was going to be repealed.

I think we're beyond that. I have made implementation of Dodd-Frank, getting the rules out of all the agencies that still have rulemakings to do, a very high priority, because one of the things that's going on is there is a concern about what they don't yet know. There are rules that haven't been settled down and they're concerned that they're going to go in a way that won't reflect either the legislative or prior regulatory sentiments that took account of the concerns of smaller institutions.

I can't sit here today and say exactly what each of the different regulators will do. But as I've discussed this issue with representatives of each of the regulatory bodies, I'm quite confident that they are thinking about this very hard and trying to address these concerns as best they can.

I think that the size issue alone is one factor. We are not taking the view as we implement Dodd-Frank that a small institution that presents no risk should be treated as if it were a money center bank. I don't know any agency that's doing that.

On the other hand, each of the regulators is asking the question: Is there a systemic risk that needs to be addressed? And as they resolve those issues, I'm certainly hopeful that it will provide the kind of clarity so that some of these issues will subside, and I hope that that's in the near future.

Senator MORAN. Mr. Secretary, thank you. I appreciate that answer, at least in part. The uncertainty is clearly a problem.

Secretary LEW. I've heard that uncertainty as much as substance is what they're worried about.

Senator MORAN. And I would tell you that I've had this conversation with your predecessor, with the Federal Deposit Insurance Corporation, other regulators over—I serve on the Banking Committee, serve on this subcommittee. The suggestion that we take into account is one that is always offered in return to the dialogue or monologue that we just had, and the complaints continue.

So I'm happy to hear you pursue the certainty. Please take into account the lack of systemic risk.

RELEASE OF TAX RETURN INFORMATION

I only have less than 30 seconds left. I'm going to submit for the record a question to you and to Acting Commissioner Miller. It deals with this issue of the IRS's inadvertent release of tax returns that appear to involve contributions to certain political organizations and the information that is released ends up in the hands of other kind of politically oriented organizations. I'm going to outline a number of instances where that has happened and ask you and the Commissioner to explain what's going on at the IRS, what's happening at the Treasury Department, how did these releases occur, what actions have you or the Commissioner taken to make sure they don't happen in the future, that employees if they are culpable have been punished.

Nothing I've seen has suggested that the issue of this release of very personal and confidential information, which may be used for political means, political outcomes, that there's been any reaction or response from the IRS or the Treasury Department.

Secretary LEW. Happy to look at that, Senator.

Senator MORAN. And I'll submit that for the record, but I'm very interested in making certain that every American, whatever their political views are, they can know that their tax return is nothing that's going to become public.

Secretary LEW. I'm happy to look at it. I can say as a principle we totally agree that there should be no politics in the execution of our tax laws.

Senator MORAN. Thank you very much, Mr. Treasury Secretary.

[NOTE: *See* in the "Additional Committee Questions" at the end of the hearing the Internal Revenue Service's and the Department of the Treasury's responses to Senator Moran's question above.]

Senator MIKULSKI. Senator Udall.

Senator UDALL. Thank you. Thank you very much, Madam Chair.

Secretary Lew, thank you for joining us here today, and thank you for your very nice comments about Senator Lautenberg. We all hope that he returns very, very soon.

I also want to thank the chairwoman and the members of the subcommittee and the staff for all their hard work on these issues. You've done an excellent job.

ECONOMIC RECOVERY FOR LOCAL COMMUNITIES

Secretary Lew, I completely agree with your statements that, even though our economy is improving, more work is necessary to support job creation and accelerate growth. In every community across New Mexico, I hear the same concerns: Jobs are hard to come by and businesses are struggling to stay open. Hard-working New Mexicans feel that the recovery hasn't come to Main Street and to rural towns.

Can you speak to what efforts Treasury has under way to help the recovery reach Main Street? How are the Treasury programs supporting vibrant local economies in cities and small towns, and how do these efforts help support a strong—building a stronger middle class?

Secretary LEW. Senator, I think we have to start with the big picture. We need to get overall economic growth growing faster, because we do need to grow more and create more jobs for it to reach all the parts of our country that need to get the benefits of a growing economy. So part of it is at the macro level, which gets me back to we shouldn't be creating headwinds for the economy.

On a more narrow basis, the Treasury Department has a number of programs. Some of them we've talked about a little bit already this afternoon, from CDFI, the Build America bonds that do provide direct support to communities and institutions that are really getting at the need for growth in parts of our States and cities that otherwise might be left behind.

We're very proud of what we've accomplished in programs like CDFI. We are, through our home ownership programs, Home Affordable Modification Program and Home Affordable Refinance Program, targeting the communities that have been hardest hit. There's more work to do.

I think we can't look at Treasury alone. We have to look at Treasury together with what we're doing in the other agencies working together. So we have transportation programs going into some of those communities. We have education programs going into some of those communities. And we've tried in this administration as much as we can to concentrate the efforts of the different parts of the Federal Government so that we go into an area in a coordinated way.

Something that I think is very important in our budget, not in the Treasury budget, is the manufacturing hubs that the President has proposed. I was in Ohio yesterday and it's really pretty striking when you talk to a business person who was able to get into an abandoned warehouse and create a high tech company because we brought the kind of power of coordinating what we do in an area together in less than a year.

I think if we were to build 15 more of those, that would be 15 more pockets of growth in areas of the country that might otherwise be left behind. I think as you look through the President's budget there are many things that are about getting at the hard-hit communities. They do all require resources and it's a tradeoff when we make budget decisions, both in terms of where we allocate resources and how we make the tradeoff between revenues and spending. I think that spending to grow the economy is something that would leave us stronger and leave our economy stronger.

Senator UDALL. Thank you very much for that answer.

You talk about manufacturing hubs. We are very hopeful in New Mexico that having these two stellar national laboratories, good universities, the kinds of resources that you've talked about there in Ohio, to all put forward and try to get one of these manufacturing hubs going. I think it's the key to the future. It's the key to getting in front of the issues we have. So we really look forward to working with you on that.

Secretary LEW. I would just add, Senator, we've done these things successfully before and we've done them on a bipartisan basis. I was proud in another administration, the Clinton administration, to work with the Republican Speaker, Speaker Hastert, on a New Markets Initiative that has done the same thing through tax benefits. So when we put our minds together and say we're going to target a program to really help build communities, we can get a lot done.

Senator UDALL. Thank you, Madam Chair.

Senator MIKULSKI. Mr. Secretary, Senator Lautenberg had some questions which I'm going to submit for the record and ask you and your team to respond in the next few weeks.

Secretary LEW. Happy to do that, Senator.

Senator MIKULSKI. They relate to Iranian sanctions and their implementation and efficacy; also the implementation of alcohol and tobacco tax evasion; and then also his very deep concern about the efficacy and the good works of the Treasury foreclosure relief programs, particularly as it affects New Jersey.

I'd like to submit them to you in writing, which is actually in his own words, which are pretty clear and direct, as is his way.

Secretary LEW. Be happy to respond in writing, Senator.

[NOTE: *See* in the "Additional Committee Questions" at the end of the hearing the Department of the Treasury's responses to Senator Lautenberg's questions submitted for the record.]

CYBERSECURITY MEASURES

Senator MIKULSKI. Also, I just want to say that, as the Chair of the full committee and a member of the Intelligence Committee, we would like to be in conversation with you about cyber security. Both you as well as Acting Commissioner Miller are the keepers of such an enormous amount of data, particularly in terms of individuals and businesses, related to everything from our concern about identity theft and other things related to even cyber espionage.

Also, the concern that our Appropriations Committee has for the protection not only of dot-gov, but also of dot-com, and the impact that we're concerned about the rising attacks on financial services that have occurred both overseas and the attempt here, the attack on NASDAQ and so on, and the implication that that could have for our economy.

So we don't think that this is the forum for kind of the robust and meaty conversation I know our colleagues and those on the Subcommittees on Defense and Homeland Security as well as myself chairing the CJS Subcommittee funding the FBI, because we really want to protect critical infrastructure. That's number one.

Number two, we really want to make sure that our financial services in the private sector are well protected and we have the right legislation to do that.

The second is to make sure we protect the dot-govs that are the repositories of an incredible amount of information about American people, American citizens, and American businesses both small and large. I'm particularly worried about the small guys because they don't have the wherewithal to act with the security of Bank of America and these others.

Secretary LEW. Senator, I think you've just put your finger on a very important problem. I've put a lot of my own time into cybersecurity issues since I've been at Treasury and before, because I think it's on that very short list of really dangerous things that could happen on our watch or right after. It's emerging as a bigger and bigger risk.

Every time I'm out, in my office or in the country talking to business people, it's on their minds and I think it's on individuals' minds because of the individual identity theft as well.

One of the things that I'm committed to doing is making sure that we don't just solve the problem we see today and say we're done. We have to stay on it, because the threats evolve and they change. It's not like you get to check the box and say we did that. This is a new way of life that we just have to stay on. But it's one of the reasons why we also need to have the resources to stay on top of it, because that takes putting people on these issues.

I've met with bank representatives a couple of times already to discuss what can we do to help them, big and small. The big institutions, I think you're right, are focusing a lot of resource on this. The smaller ones I'm afraid are not necessarily doing it as much. I think they're beginning to. But that's where we have a special role to play coordinating and making sure we share information and that we can make it possible for them to share information.

And legislation is really necessary. The Executive order the President put into effect is a very important step, but legislation is necessary to really give us the tools we need.

Senator MIKULSKI. Well, the President has issued his Executive order, and I'm contemplating exercising my authority as full committee chair to have a full committee hearing on cybersecurity, because this affects financial services, DOD, homeland security, one, on the implementation of the President's Executive order, information-sharing and some others, that we have the wherewithal to move ahead on that, and at the same time that the full committee grasp what this is so we're all moving in the same direction in enabling agencies such as yours to take the necessary steps to protect dot-gov while we're looking to really work in partnership to protect the dot-coms.

Secretary LEW. We would look forward to working with you, Senator.

Senator MIKULSKI. Thank you. And I say that to my colleagues.

Well, Mr. Secretary, thank you very much for being here today. We're going to move now to taking testimony from the IRS——

Secretary LEW. Thank you, Senator.

Senator MIKULSKI [continuing]. As well as the Inspector General. So thank you, until we meet again.

Now we ask Mr. Steven Miller and Mr. J. Russell George, our Treasury Inspector General for Tax Administration. I must say, Mr. George, we welcome you to the table, but we have two distinguished jurists in Maryland, Mr. George Russell. So you've got the names transposed here a bit, but I gather you're as distinguished as my two colleagues.

Colleagues, I invited Mr. George to testify, as I have on my own subcommittee and encouraged other subcommittee chairmen, so we have the benefit of the thinking of the Inspector Generals. You know, they identify management problems, give us a heads-up if we're heading to some technology boondoggles, which I know we're worried about. They contribute a sense of frugality, smart government, and perhaps some reforms that we could come together to support.

But having said that, Mr. Miller, you're the Acting Commissioner of IRS. You have a big job and we're going to give you a big opportunity to tell what you need. Would you please proceed.

INTERNAL REVENUE SERVICE

STATEMENT OF STEVEN T. MILLER, ACTING COMMISSIONER

Mr. MILLER. Thank you, Chairwoman Mikulski, Ranking Member Johanns, and the members of the subcommittee. I appreciate the opportunity to testify today.

Before I give more detail on the proposed budget, if I could, let me report on this year's filing season. I'm happy to report that the current filing season ran very smoothly. Through April 20, the IRS received 130 million individual returns, issued 94 million refunds, for a total of $250 billion. This unfolded despite the difficult challenges presented by substantial tax law changes that were not enacted until January 2.

In terms of the fiscal year 2014 budget, our request, I believe, represents a fair balance of service, enforcement, and innovation. The taxpayer service highlights include improving our phone service and providing for more online self-service options.

Enforcement initiatives include increasing the resources and tools available for identity theft, addressing international issues, and improving the manner in which we use data. Note that for each dollar we receive, we will return multiples of that to the U.S. Treasury. If enacted, the enforcement initiatives of the fiscal year 2014 budget are estimated to increase revenue collected or protected by more than $3.5 billion.

My testimony outlines our recent accomplishments. We have delivered a smooth filing season now and in the past, and successfully carried out core duties while making important progress on a number of other initiatives. An example is our effort to address identity theft. More than 3,000 IRS employees are working on identity theft, more than double the number at the start of last filing season.

Last fiscal year the IRS expended nearly $330 million of our budget on identity theft and refund fraud, and it was money well spent. During fiscal year 2012 the IRS protected more than $20 billion of revenue, up from $14 billion the prior year. So far this filing season, the IRS has suspended or rejected more than 3.3 million suspicious returns.

Now, I know that the current budget environment is tight, but it's important to understand that these and other accomplishments are not sustainable if our budget continues to atrophy. Yes, I think we'll continue to succeed with the filing season, and we will continue our efforts to maintain excellence in performance. But that performance will begin to reflect the impact of the large budget cuts that we've received over the last few years.

This means that there will be a steady erosion in the service we provide to taxpayers and in the amount of money that we collect. In this regard, let me note the effects of the sequester. We've said publicly that the IRS faces up to 7 furlough days this fiscal year.

We anticipate a considerable reduction in the revenues we collect and the calls we can answer as a result of sequestration. Some of these impacts, in particular our ability to answer phones, will begin to be felt now that the filing season is over.

We've become more efficient even as our budget has been reduced by around $1 billion since fiscal year 2010. That represents almost an 8-percent cut in our budget, even as we have been asked to tackle significant new challenges, including identity theft, ACA, and the foreign accounts work under FATCA. We've met some of this reduction by cutting expenses by almost $500 million in recent years. The fiscal year 2014 request contains another $255 million of savings and efficiencies. And we've also been strategic in our hiring decisions, using buyouts and reducing expenses in nonlabor areas as well. By closely managing hiring, we've seen a reduction of a total number of our full-time permanent employees by almost 7,000 to 8,000 between fiscal year 2010 and the present. Note that this filing season we ran nearly 10,000 employees below where we were during the filing season in 2010.

In our nonlabor spending, we've limited operating travel to mission-critical needs and increased the use of virtual delivery of meetings and training, allowing the IRS to reduce costs by a total of $158 million on an annual basis, a 55- percent reduction from fiscal year 2010. There's also been reduced spending on professional and technical services by $200 million and $60 million in printing and postage savings, as well as aggressive reduction in rent payments.

PREPARED STATEMENTS

Madam Chairwoman, we will continue our efforts to be fiscally prudent and to make wise investments in our strategic priorities and enforcement, service, and business modernization. However, as I've noted, without a change in the current budget environment the American people will see erosion in our ability to serve them and the Federal Government will see fewer receipts from our enforcement efforts.

Thank you for the opportunity.

[The statements follow:]

PREPARED STATEMENT OF STEVEN T. MILLER

INTRODUCTION

Chairman Lautenberg, Ranking Member Johanns, and members of the subcommittee, thank you for the opportunity to appear before you today to provide you with an overview of our proposed fiscal year 2014 budget and what we hope to accomplish with those resources.

The fiscal year 2014 budget request for the Internal Revenue Service (IRS) was crafted during a time of fiscal austerity and belt tightening. The IRS remains committed to being as efficient as possible and spending taxpayer dollars wisely. We will continue to find savings wherever we can, while investing in strategic priorities that allow us to fulfill our dual mission of strong enforcement of the tax laws and excellent customer service. The IRS consistently achieves a high return on investment for its activities while running a fiscally disciplined operation.

The IRS is vital to the functioning of government and keeping our Nation and economy strong. In fiscal year 2012, the IRS collected $2.524 trillion in gross revenue to fund the Federal Government, approximately 92 percent of all Federal receipts. Moreover, for fiscal year 2012, we processed more than 147.6 million individual tax returns and issued more than 121.6 million refunds to individual taxpayers totaling $333 billion.

The IRS will use the funding in the President's budget request to carry out its mission, which includes:

—improving service to taxpayers;
—increasing our efforts against refund fraud;
—making our compliance efforts more strategic;
—using new tools, data, and capabilities to conduct a balanced enforcement program, including improving our use of data received through third-party information reporting; and
—taking the next steps in building out our e-filing platforms and taxpayer account database.

The IRS will also continue to administer tax-related provisions of major legislation, including the Foreign Account Tax Compliance Act (FATCA) and the Affordable Care Act.

It is important to understand that the accomplishments outlined below may not be sustainable within the current budget environment. We will continue to attempt to maintain our excellence, but our performance could begin to reflect the impact of the budget cuts of the last few years. This does not mean there will be a catastrophic event or failure at the IRS; however, there could be a steady erosion in the service we provide to taxpayers and in the amount of money we collect through enforcement activities. We will continue to find efficiencies, and you will see that we have been aggressive in recent years in this regard. We will continue to dedicate staff and resources to the most essential uses and in the most critical areas. For example, we will continue to commit staff to resolving identity theft cases, even at the cost of having fewer people on our toll-free taxpayer service line or on our automated collection phones that help us collect past due taxes.

A RECORD OF SUCCESS

Let me outline what we have accomplished. The IRS is proud of its record over the last several years. We have delivered smooth filing seasons and successfully carried out other core duties while also making important progress on a number of strategic initiatives. These initiatives include:

—cracking down on international tax evasion;
—fighting all refund fraud, but especially that related to identity theft;
—improving return preparer compliance;
—leveraging data analytics in order to improve our operations;
—modernizing our technology to benefit both taxpayer service and compliance; and
—positioning our workforce to ensure the IRS is prepared for tomorrow's challenges.

The 2013 filing season started with difficult challenges for the IRS. As the subcommittee is aware, substantial tax law changes were enacted on January 2 of this year, just before the IRS would normally begin accepting e-filed returns. IRS staff worked around the clock to make changes to systems and forms necessary to open the tax filing season. I am pleased to say that, as a result of exceptional planning and hard work by our employees, all but a discrete minority of taxpayers were able to begin filing in late January, and all were able to file by early March.

Despite the challenges we faced at the outset, the filing season ran smoothly. Through April 20, 2013, the IRS received 129.94 million individual returns and issued 93.8 million refunds for a total of $249 billion. The average dollar refund is about $2,650 and the IRS has directly deposited more than 76 million refunds to taxpayers thus far. In addition, our strengthened refund fraud detection tools have been working well. As for customer service, accuracy rates for both customer tax law and accounts questions remain in the 90-plus percentile.

In the last few months alone we have had several other signs that we are achieving success in some of the initiatives I mentioned above.

On the technology front, the Government Accountability Office (GAO) in February removed the IRS Business Systems Modernization program from its high risk list, where it had been since 1995. Citing the work the IRS has done to bolster information technology and financial management capabilities, the GAO concluded that the IRS had made substantial progress in addressing weaknesses over the past several years and had demonstrated a commitment to sustained progress. The GAO singled out delivery of the initial phase of the Customer Account Data Engine (CADE2), which has enhanced tax administration and improved taxpayer service.

In March 2013, the Excellence.gov Awards Program sponsored by the American Council for Technology and the Industry Advisory Council recognized CADE2 for Excellence in Enterprise Efficiencies. This awards program honors government programs and projects that use information technology in innovative ways to enhance government operations, provide a more open and transparent government, and deliver important citizen resources.

IRS is also maintaining quality on the customer service front. Every year, an independent survey is conducted by the American Customer Satisfaction Index (ACSI). For 2012, the survey of taxpayers who were satisfied with IRS services reached 75 on a scale of 100, up from 73 in 2011, and our highest score since 1994 when we began participating in the survey.

The following are some of the more prominent IRS programs and initiatives conducted during fiscal year 2012, including those within our core programs, which demonstrate how targeted investments continue to deliver real value to taxpayers and our Nation.

ENFORCEMENT

Enforcement of the tax laws is an integral part of the IRS' effort to enhance voluntary compliance. IRS enforcement activities, such as examination and collection, remain a high priority. In fiscal year 2012, collections related to all enforcement activities exceeded $50 billion for the third consecutive year. The IRS has shown significant progress in several key enforcement programs. Importantly, we also were able to hold individual audit rates more than 1 percent during a period of scarce resources, and we increased criminal investigations by 5.1 percent, to 4,937.

International Tax Compliance

In fiscal year 2012, the IRS enhanced international tax compliance efforts through the implementation of new legislation and through programs such as the Offshore Voluntary Disclosure Program (OVDP). In January 2012, the IRS reopened the OVDP with tightened eligibility requirements in response to strong interest from taxpayers and tax practitioners. Through the end of fiscal year 2012, the OVDP has resulted in a total of more than 38,000 disclosures of unpaid taxes and collected more than $5 billion in back taxes, interest, and penalties.

Also during fiscal year 2012, the IRS worked closely with businesses and foreign governments in implementing FATCA. This legislation strengthens offshore compliance efforts by requiring all foreign financial institutions with U.S. accounts to report detailed information about foreign account holders to the IRS or face a 30 percent withholding tax. The administration's fiscal year 2014 budget request allows for more work in this area, and in particular funds our work on FATCA's new offshore account reporting rules.

Tax Return Preparer Program

The IRS continued implementation of its Return Preparer Program, begun in fiscal year 2011. The foundation of this program is mandatory registration for all paid tax return preparers. Through September 2012, more than 860,000 preparers have requested Preparer Tax Identification Numbers (PTINs) using the online registration system.

In February 2013, a Federal court stopped the IRS from enforcing the competency testing and continuing education requirements for registered return preparers. The injunction does not apply to the requirement to obtain a PTIN, so that portion of the program continues. But at this time we are not permitted to move forward with testing or continuing education requirements. We remain confident in our legal authority and remain committed to protecting taxpayers through implementing reasonable standards in this area. The original district court opinion is under appeal.

The PTIN registration requirement provides an important and improved view of the return preparer community from which the IRS can leverage information to improve communications, analyze trends, spot issues, and detect potential fraud. And we are developing new approaches in this area. For example, one pilot we conducted in 2012 used real-time data to assess the fraud risk associated with Earned Income Tax Credit (EITC) return preparers and test the effectiveness of alternative compliance treatments. This pilot involved 1,500 preparers who filed large numbers of returns claiming the EITC. Taken together, the various compliance treatments we used in the pilot resulted in a total savings on improperly claimed tax credits—including the EITC and the Child Tax Credit—of approximately $200 million. We continue to develop new approaches in this area.

Refund Fraud and Identity Theft

Our efforts to address identity theft and refund fraud are expanding and touch nearly every part of the IRS. We are working hard to prevent fraud, investigate identity theft-related crimes, and help taxpayers who have been victimized by identity thieves. More than 3,000 IRS employees are currently working on identity theft—more than double the number at the start of last filing season. We have also trained 37,000 employees who work with taxpayers to recognize identity theft and help victims. Since the beginning of 2013, the IRS has worked with taxpayers victimized by identity theft to resolve and close more than 200,000 cases. To help past identity theft victims avoid delays in filing future returns and receiving refunds, we expanded the issuance of Identity Protection Personal Identification Numbers to more than 770,000 past victims this year, more than twice as many as last year.

Last fiscal year, the IRS significantly expanded its fraud detection efforts, expending nearly $330 million combating refund fraud, including identity theft. During fiscal year 2012, the IRS protected more than $20 billion of revenue related to fraudulent returns, including identity theft, up from $14 billion in the prior year. IRS efforts stopped 5 million suspicious returns in 2012—up from 3 million stopped in 2011.

So far this filing season, the IRS has suspended or rejected over 3 million suspicious returns. More than 800,000 of these were rejected at the point of filing before they even entered IRS processing systems. The remaining returns generally require further review to determine whether the filer is legitimate. Because these returns require time to review, most are still in open inventory at this time. To date, we have stopped more than 600,000 refunds determined to be fraudulent, worth more than $4 billion. And this is in addition to the refunds saved on the 800,000 rejected returns.

This January, the IRS also conducted a coordinated and highly successful identity theft enforcement sweep. The coast-to-coast effort against identity theft suspects led to 734 enforcement actions in January, including 298 indictments, informations, complaints, and arrests. These activities come on top of a growing identity theft effort that led to 2,400 other enforcement actions against identity thieves during fiscal year 2012.

The IRS also has been working to assist State and local law enforcement agencies in the efforts they are making to fight identity theft-related refund fraud. One way we have done this is by developing the Identity Theft Victim Disclosure Waiver Process, which was launched in Florida in April 2012.

This program provides for the disclosure of Federal tax returns and return information associated with the accounts of known and suspected victims of identity theft with the express written consent of those victims. Prior to disclosing any tax information, victims are required to sign a waiver authorizing the release of information to the designated State or local law enforcement official pursuing the investigation. To date the IRS has received more than 1,560 waiver requests from more than 100 State and local law enforcement agencies in the nine States that have been participating in the pilot. On March 28, 2013, the IRS announced that this program has been expanded to all 50 States.

TAXPAYER SERVICE

By assisting taxpayers with their tax questions before they file their returns, the IRS helps prevent inadvertent noncompliance and reduces burdensome post-filing notices and other correspondence from the IRS. Accordingly, the IRS provides year-round assistance to millions of taxpayers through many sources, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, IRS.gov, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites.

2012 Filing Season

Despite a number of challenges, the IRS delivered another successful filing season. During fiscal year 2012, the IRS received more than 147.6 million individual returns and issued more than 121.6 million refunds totaling $333 billion. More than 82.8 million refunds were direct deposited, which is a 4.9 percent increase from the 78.9 million direct deposited in fiscal year 2011. In addition, IRS employees responded accurately to 93.2 percent of tax law questions and 95.6 percent of taxpayer account questions.

The IRS' e-file program continued to grow, with more than 118.9 million individual returns, or 80.5 percent, filed electronically, an increase of 4.7 percent from the previous year. Other increases in electronic filing results during the 2012 filing season include the following:

—Business returns filed electronically were up by 15 percent to 36.7 percent;

—Filing via home computers increased by 9.8 percent to 43.5 million tax returns; and

—Tax professionals' use of e-file rose 5.4 percent to 75.6 million returns.

Helping Distressed Taxpayers

The IRS' commitment to customer service also means assisting taxpayers who are facing difficult economic times and other hardships. For example, the IRS provided significant support to the Federal Emergency Management Agency (FEMA) in the aftermath of Hurricane Sandy. Before the storm dissipated, the IRS initiated its response, activating 600 employees to answer phone calls beginning on October 29, 2012. That number ultimately grew to 3,000 employees answering 188,175 calls before the Registration Intake Line was deactivated 6 weeks later on December 4. Given the level of devastation, FEMA also requested IRS assistance in staffing its Help Line, and IRS employees answered 149,000 of those calls. In addition to this direct assistance, the IRS also moved quickly to provide tax relief to victims of Hurricanes Sandy and Isaac through actions such as extending return filing and payment deadlines.

Also in 2012, the IRS expanded the Fresh Start initiative to help struggling taxpayers meet their tax obligations. Changes included:

—Increasing the dollar threshold and repayment period for individual installment agreements;

—Providing more financial analysis flexibility for installment agreements and Offer in Compromise programs;

—Issuing new guidance to address unsecured debts such as student loans, credit cards, and State and local taxes;

—Providing a 6-month grace period to certain wage earners and self-employed individuals on failure-to-pay penalties; and

—Extending help to taxpayers eligible for the Innocent Spouse Program by eliminating the 2-year timeframe for consideration of certain innocent spouse claims.

IRS.gov and Social Media

The IRS continued to provide alternative service options by increasing the amount of tax information and services available to taxpayers through IRS.gov. In fiscal year 2012, taxpayers viewed IRS.gov more than 370 million times. These taxpayers used IRS.gov to get forms and publications, find answers to their tax questions, and check the status of their refunds. Taxpayers used the "Where's My Refund?" electronic tracking tool more than 132.3 million times.

The IRS is increasing communications with taxpayers who do not get their information from traditional sources, such as newspapers and broadcast and cable news. By employing social media such as YouTube and Twitter, the IRS reaches these taxpayers and provides important service and compliance messages to them.

Of particular note is the IRS presence on YouTube. We have YouTube videos in English, Spanish, American Sign Language, and other languages. These videos contain useful information for taxpayers. There are now more than 100 IRS videos, which have been viewed more than 5.5 million times. The "Where's My Refund?" video surpassed 1 million views this filing season. The IRS now ranks fourth in YouTube viewership among government YouTube channels.

In addition to the IRS presence on Twitter, our social media work has recently been expanded to include Tumblr—a microblogging platform where users access and share text, photos, videos, and other information from browsers, smartphones, tablets, or desktops. We are using Tumblr to share information about important programs to help taxpayers, such as late tax law changes, the EITC, and Free File.

Also during fiscal year 2012, the IRS released an updated version of its IRS2Go Smartphone application with new features that let taxpayers interact with the IRS using their mobile devices. To date, there have been more than 1.9 million downloads of the application, and more than 6.2 million applications launched. On April 2, 2013, the IRS announced that, for the first time, the IRS2Go application is available in Spanish.

Outreach and Education

The IRS enhanced its outreach and education services during fiscal year 2012 by collaborating with State taxing authorities, volunteer groups, and other organizations to address taxpayer needs. By supporting more than 3,900 local partners and a combined 13,143 VITA and TCE sites, the IRS provided free tax assistance to the elderly and the disabled, as well as to individuals with limited proficiency in English.

In fiscal year 2012, nearly 99,000 volunteers prepared almost 3.3 million Federal returns and more than 2.5 million State returns, which represent increases over fiscal year 2011 of 2.4 percent and 5.9 percent, respectively. In addition, 95 percent of the Federal returns under these programs were filed electronically.

BUSINESS SYSTEMS MODERNIZATION

IRS modernization efforts focused on building and deploying advanced information technology systems, processes, and tools to improve efficiency and productivity.

The IRS reached a major milestone in its modernization efforts in January 2012 with the launch of its Customer Account Data Engine (CADE2). Up to this point, the IRS had been performing core account processing on a weekly basis. Launching CADE2 meant the IRS successfully migrated to daily processing and posting of individual taxpayer accounts, enabling faster refunds for more taxpayers, more timely account updates, and faster issuance of taxpayer notices.

The IRS also made important progress on another front when Modernized e-File (MeF) Release 7 became operational in January 2012. The enhancements of Release 7 expanded the reach of MeF to cover 100 percent of the 1040 population filing electronically. The IRS processed nearly 107 million individual Federal and State returns and more than 14.3 million Business Master File returns through MeF. MeF is a major improvement over the previous system, which processed returns in several batches per day, rather than in real time. MeF reduces turnaround time, improves processing, and allows acknowledgments to be sent much more quickly to transmitters.

WORKING SMARTER AND FINDING EFFICIENCIES

Over the last several years, IRS budget requests have reflected strategic investments in the IRS that 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. Over the past five President's budget submissions (for fiscal year 2009 through fiscal year 2013), the IRS declared almost half a billion dollars ($486 million) in budget savings. In addition to these declared savings, the IRS has faced reductions to its budget each year since fiscal year 2010, even as we took on new legislatively mandated responsibilities.

Since fiscal year 2010 and including the current fiscal year, IRS appropriations have been cut by nearly $1 billion (including more than $600 million in reductions from sequestration and rescissions this year). This represents nearly an 8 percent cut of our annual budget while the total population of individual and business filers grew by more than 4 percent over the same time period. At the same time, we have tackled significant new challenges, including: implementing merchant card and basis reporting, implementing the Affordable Care Act's tax provisions and new requirements for foreign financial institutions under FATCA, and addressing the sharp growth in refund fraud and identity theft.

While the IRS will continue to be an efficient steward of taxpayer resources, improving and investing in our critical programs under continually reduced funding levels has been difficult. Labor is our largest operating expense, and we have been very focused on managing personnel costs. We have operated under an exception-only hiring freeze since December 2010. In fiscal year 2012 we secured buyout authority that resulted in the elimination of 1,224 positions that did not involve direct service or enforcement interactions with taxpayers. By closely managing hiring, we reduced the total number of full-time, permanent IRS employees by almost 7,000 between the end of fiscal year 2010 and fiscal year 2012. So far this year, we have further reduced full-time permanent staffing through attrition by another 1,000 full-time employees—thus, we are down 8,000 permanent employees since 2010. Of these, more than 5,000 are front-line enforcement employees.

The IRS has also implemented significant reductions in its non-labor spending. By limiting operating travel to mission-critical needs and increasing the use of virtual delivery for meetings and training, the IRS reduced travel costs by a total of $158 million in fiscal year 2011 and fiscal year 2012, a 55 percent reduction from fiscal year 2010. Over the same timeframe, we also reduced spending on professional and technical service contracts by $200 million. Additionally, the IRS generated $60 million in printing and postage savings by eliminating the printing and mailing of selected tax packages and publications, and by transitioning to paperless employee pay statements.

Finally, in an effort to promote more efficient use of the Government's real estate assets and to generate savings, the IRS announced last year a sweeping office space and rent reduction initiative that over 2 years is projected to close 43 smaller IRS offices and consolidate space in many larger facilities.

These measures will reduce rent costs by more than $40 million and reduce total IRS office space by more than 1.3 million square feet by the end of fiscal year 2014. These savings will be realized with little or no impact on taxpayer service or enforcement efforts. Some examples of projects currently underway include consolidating the IRS Detroit Computing Center space for a projected annualized rent savings of $15.8 million, and a reduction in rent in midtown Manhattan for an annualized savings of $4.4 million.

IRS WORKFORCE

The IRS remains focused on its efforts to become one of the best places to work in the Federal Government. We can only serve the Nation's taxpayers well if we have engaged employees who are respected and challenged, and whose managers support them, help them do their jobs, and hold them accountable.

In 2008, we created the Workforce of Tomorrow task force, which has generated many workplace initiatives to help us achieve the improvements we seek. Last fall, the Partnership for Public Service released the results of the 2012 Best Places to Work in Federal Government survey. It showed the IRS is currently ranked 98th among 292 organizations, only slightly lower than 2011 and still significantly higher than 2010. And we ranked third out of 15 large agencies—those with 20,000 or more employees—in that survey's employee engagement index.

In addition, we held our ground or improved our ranking in three of the four IRS Human Capital Strategy Measures. We finished second only to the Department of State in measures related to leadership and knowledge management.

These survey results are especially heartening because of the challenges our employees have faced over the past year, including budget uncertainty and freezes on pay and hiring. These survey results reflect the deep commitment and dedication of the IRS workforce to delivering for the American taxpayer.

THE ADMINISTRATION'S FISCAL YEAR 2014 BUDGET REQUEST FUNDS KEY PRIORITIES

The fiscal year 2014 President's budget request is $12,861,033,000 in direct appropriations and an estimated $110,627,000 from reimbursable programs, with an additional estimated $277,582,000 from user fees for a total operating level of $13,249,242,000. The direct appropriation is $1,044,337,000 more than the fiscal year 2012 enacted level of $11,816,696,000.

The overall request is designed to provide the resources necessary to administer and enforce the current tax code, implement recent changes to the code, conduct a robust and sophisticated enforcement program, and serve taxpayers in a timely manner. Helping taxpayers understand their obligations under the tax law is critical to improving compliance and addressing the tax gap, the difference between taxes owed and taxes paid on time. Therefore, the IRS is committed to making the tax law easier to access and understand, and to improving voluntary compliance and reducing the tax gap through both taxpayer service and enforcement programs.

Enforcement Program

The fiscal year 2014 budget request for IRS enforcement activities includes a $412 million program integrity cap adjustment that will increase enforcement revenue and reduce the budget deficit through above-base funding for high return on investment (ROI) tax enforcement and compliance programs. Of that total, $5 million will be transferred to the Alcohol and Tobacco Tax and Trade Bureau (TTB). The remaining $407 million will fund new activities that will enhance tax administration and build enforcement capabilities. Once new hires are fully trained and have gained experience to reach their full potential in fiscal year 2016, these resources are expected to raise $1.6 billion in additional revenue annually. The average return on investment for these activities is more than $6 to $1. The return on investment is even greater when factoring in the deterrence value of these investments and other IRS enforcement programs, which is estimated to be at least three times the direct revenue impact.

Specific areas where the proposed fiscal year 2014 funding will enable the IRS to continue to strengthen enforcement efforts and reduce the tax gap include:

—Strengthening enforcement activities to address offshore tax evasion and expand the IRS' global presence and pursuit of international tax and financial crimes. This includes implementing changes required by the Foreign Account Tax Compliance Act (FATCA) such as new reporting, disclosure, and withholding requirements. The IRS will also continue to address tax-avoidance schemes involving unreported offshore accounts;

—Enhancing enforcement activities in connection with partnerships and other flow-through entities, in light of the fact that partnership businesses continue to be the fastest growing segment of all tax returns filed;

—Continuing the IRS' efforts to focus on high-wealth taxpayers by increasing risk identification, case building and examination capabilities; and

—Building on previous efforts to strengthen return preparer compliance, to improve taxpayer compliance and the accuracy of returns filed by tax professionals.

Refund Fraud and Identity Theft

The request provides $101 million to support IRS efforts to prevent identity theft-related refund fraud, protect taxpayers' identities, assist victims of identity theft, and enhance the revenue protection strategy implemented in fiscal year 2013.

The increase in funding will support the development and implementation of technology enhancements to identify noncompliant returns before refunds are issued, manage and track workload and case results, send notification letters to taxpayers, and allow third-party data to be used earlier in the filing season. This enhancement will improve detection of fraudulent returns and reduce delays of legitimate refunds due to pre-refund compliance activities. Investment in these activities is projected to protect $1.3 billion in revenue, once the new hires reach full potential in fiscal year 2016—a revenue protection return on investment estimated at more than $14 to $1.

Taxpayer Service Program

The fiscal year 2014 request includes funding to allow the IRS to improve customer service to meet taxpayer demand and continue delivering services to taxpayers using a variety of in-person, telephone, and Web-based methods, to help taxpayers understand their tax obligations, correctly file their returns, and pay taxes due in a timely manner.

Taxpayer demand for self-service and electronic service options at the IRS has been dramatically increasing in recent years. To support this demand, and to transition taxpayers to less expensive, more efficient operations, the IRS request includes resources to support the Treasury Department's efforts to expand the use of electronic transactions, including new service options that will allow more taxpayers to interact with the IRS through the Internet.

Specifically, the IRS is developing taxpayer and practitioner self-service applications that do not exist today, such as viewable eTranscripts, Power of Attorney and Online Payment Agreements, and Installment Agreements.

The increased funding will also facilitate the deployment of 100 new Virtual Service Delivery (VSD) video technology units, which allow face-to-face contact between IRS employees and taxpayers at remote sites through two-way video conferencing. The IRS will be able to resolve taxpayer issues virtually at understaffed and unstaffed TACs, Taxpayer Advocate Service sites, and Low Income Tax Clinic locations. VSD video will also allow the IRS to explore connecting virtual tax examinations and other interactions with taxpayers.

Implementation of Tax Law Changes

The fiscal year 2014 budget requests funding to support IRS efforts to implement programs that are designed to ensure compliance with a number of recent changes to the tax laws, and to help taxpayers understand them. These tax law changes include the reporting provisions related to merchant card payments and third-party reimbursements (included in the Housing and Economic Recovery Act of 2008), and basis reporting on securities sales (included in the Emergency Economic Stabilization Act of 2008). The funding increase will also support compliance activities related to provisions included in the Affordable Care Act (ACA) (Public Law 111–148) such as direct-pay bonds, requirements for tax-exempt hospitals, and the fee on manufacturers and importers of branded prescription drugs.

Business Systems Modernization

The fiscal year 2014 request includes funding that will allow the IRS to build on the momentum of implementing new daily processing in 2012 and the delivery of a new database for individual taxpayer account data by investing in state-of-the-art capabilities, such as online taxpayer services, that leverage the database infrastructure that is now in place. IRS processing systems are now accepting all 1040 forms electronically, and for the first time, are feeding those returns through a single, consolidated database, the Customer Account Data Engine, or CADE2. The next phase of the CADE2 effort will eliminate the risks associated with antiquated technologies and programming languages that are still used in the current IRS environment.

EXPLANATION OF BUDGET ACTIVITIES BY ACCOUNT

Enforcement

The fiscal year 2014 President's budget request for enforcement activities is $5,666,787,000 in direct appropriations and an estimated $65,619,000 from reimbursable programs, and an estimated $18,205,000 from user fees, for a total operating level of $5,750,611,000. To reduce future deficits, a portion of this appropriation, $245,904,000, is requested as part of the $411,990,000 total program integrity cap adjustment for the IRS. The adjustment includes an above-base investment in tax enforcement and compliance programs, including $5 million that will be transferred to the Alcohol and Tobacco Tax and Trade Bureau for high return on investment enforcement activities. In conjunction with specified funds provided in the IRS Operations Support account, this increment will support tax compliance initiatives expected to generate high returns on investment in the form of increased tax revenues. This appropriation funds the following budget activities.

Investigations ($661,631,000 from direct appropriations, and an estimated $58,402,000 from reimbursable resources).—This budget activity funds the criminal investigation (CI) programs that explore potential criminal and civil violations of tax laws; enforce criminal statutes relating to violations of tax laws and other financial crimes; and recommend prosecution as warranted. These programs identify and document the movement of both legal and illegal sources of income to identify and document cases of suspected intent to defraud. This budget activity provides resources for international investigations involving U.S. citizens residing abroad, non-resident aliens and expatriates, and includes investigation and prosecution of tax and money-laundering violations associated with narcotics organizations.

Exam & Collection ($4,842,007,000 from direct appropriations, and an estimated $6,541,000 from reimbursable resources, and an estimated $5,000 from user fees).—This budget activity funds programs that enforce the tax laws and increase compliance through examination and collection programs that ensure proper payment and tax reporting. It also includes programs such as specialty tax examinations (employment tax, excise tax, and estate and gift tax exams), international collections, and international examinations. The budget activity also provides for campus support of the Questionable Refund Program and appeals and litigation activities associated with exam and collection.

Regulatory ($163,149,000 from direct appropriations, an estimated $676,000 from reimbursable resources, and an estimated $18,200,000 from user fees).—This budget activity funds the development and printing of published IRS guidance materials; interpretations of tax laws; internal advice to the IRS on general non-tax legal issues such as procurement, personnel, and labor relations; enforcement of regulatory rules, laws, and approved business practices; and support of taxpayers in the areas of pre-filing agreements, determination letters, and advance pricing agreements. The Return Preparer Strategy, in addition to the Office of Professional Responsibility (which is responsible for identifying, communicating, and enforcing the Treasury Circular 230 standards of competence, integrity, and conduct of professionals representing taxpayers before the IRS), is funded within this activity.

Taxpayer Services

The fiscal year 2014 President's budget request for taxpayer services is $2,412,576,000 in direct appropriations, an estimated $21,360,000 from reimbursable programs, and an estimated $151,242,000 from user fees, for a total operating level of $2,585,178,000. This appropriation funds the following budget activities.

Pre-filing Taxpayer Assistance & Education ($660,197,000 from direct appropriations, $98,000 from reimbursable resources, and an estimated $10 million from user fees).—This budget activity funds services to assist with tax return preparation, including tax law interpretation, publication, production, and advocate services. In addition, funding for these programs continues to emphasize taxpayer education, outreach, increased volunteer support time and locations, and enhancing pre-filing taxpayer support through electronic media.

Filing & Account Services ($1,752,379,000 from direct appropriations, $21,262,000 from reimbursable resources, and an estimated $141,242,000 from user fees).—This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically submitted tax returns, issue refunds, and maintain taxpayer accounts. This budget activity also provides operating resources to administer the advance payment feature of the Trade Act of 2002 (Public Law 107–210) health insurance tax credit program, which assists dislocated workers with their health insurance premiums.

Operations Support

The fiscal year 2014 President's budget request for operations support is $4,480,843,000 in direct appropriations, an estimated $23,648,000 from reimbursable programs, and an estimated $108,135,000 from user fees, for a total operating level of $4,612,626,000. A portion of this appropriation, $166,086,000, is requested as part of the $411,990,000 program integrity cap adjustment for the IRS tax enforcement and compliance programs, which provides an above-base investment in these programs to reduce future deficits. In conjunction with specified funds provided to the IRS Enforcement account, this increment will support new tax compliance initiatives that are expected to generate high returns on investment in the form of increased tax revenues. This appropriation funds the following budget activities.

Infrastructure ($939,182,000 from direct appropriations, an estimated $1,044,000 from reimbursable resources, and an estimated $17,137,000 from user fees).—This budget activity funds administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-IT equipment.

Shared Services & Support ($1,305,701,000 from direct appropriations, an estimated $15,806,000 from reimbursable resources, and an estimated $31,520,000 from user fees).—This budget activity funds policy management, IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equity, diversity and inclusion programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurements, and specific employee benefit programs.

Information Services ($2,235,960,000 from direct appropriations, an estimated $6,798,000 from reimbursable resources, and an estimated $59,478,000 from user fees).—This budget activity funds staffing, equipment, and related costs to manage, maintain, and operate the information systems critical to the support of tax administration programs. This includes the design and operation of security controls and disaster recovery planning. This budget activity funds the development and maintenance of the millions of lines of programming code that support all aspects and phases of tax processing and the operation and administration of the mainframes, servers, personal computers, networks, and a variety of management information systems.

Business Systems Modernization

The fiscal year 2014 President's budget request for business system modernization is $300,827,000 in direct appropriations. This appropriation funds the following budget activity.

Business Systems Modernization ($300,827,000 from direct appropriations).—This budget activity funds the planning and capital asset acquisition of information technology (IT) to continue the modernization of IT systems, including labor and related costs.

FISCAL YEAR 2014 BUDGET ADJUSTMENTS: EFFICIENCY SAVINGS

Increase e-file Savings −$5,040,000/−101 FTE.—These savings are the result of reduced paper returns. The IRS projects taxpayers will file 1,587,800 fewer paper returns (666,200 individual and 921,600 business returns) and instead choose to e-file. As a result, the IRS will need 101 fewer FTE in submission processing, generating a savings of $5,040,000.

Business Systems Modernization (BSM) Savings −$30,000,000/0 FTE.—This reduction provides an fiscal year 2014 funding level of $300,827,000 that is required for the IRS to continue modernization of critical information technology systems that support the Nation's revenue base, including the Customer Account Data Engine 2 (CADE2) and Modernized e-File (MeF) programs.

Reduce Information Technology (IT) Infrastructure −$57,500,000/0 FTE.—In fiscal year 2014, IRS IT will continue to implement industry best practices to shape the future of information technology development and ongoing operational support, to provide a more robust foundation for expanding IT capabilities in the future. In fiscal year 2014, reductions to IT resources will be managed through streamlining operational requirements. By adopting common technologies, managing demand, and taking advantage of strategic procurement opportunities the IRS will provide a more efficient use of resources.

Implement Human Capital Administrative Efficiencies −$7,858,000/−73 FTE.—The IRS will achieve human capital administrative efficiencies by reducing costs and streamlining operations. The IRS will take a number of actions to achieve these efficiencies, including: partnering with Treasury to eliminate the redundant costs of collecting duplicate HR reporting data from the National Finance Center; implementing improvements in the Human Capital employment program; and redesigning manager and employee training programs to generate savings.

Targeted Personnel Savings −$77,766,000/−683 FTE.—Although the budget request calls for increased staffing resources to support a number of strategic priorities, the IRS is also very focused on managing personnel costs and reducing staff across many operational areas. These personnel savings are the result of the annualization of fiscal year 2013 attrition savings. To achieve these reductions, the IRS reduced overall staffing by filling behind critical vacancies only; streamlined the workforce by reducing administrative, analyst, and support positions; realigned mission-critical occupations by eliminating positions vacated by employees with outdated skills and hiring employees who have the background and skills to support the IRS in meeting its strategic goals, objectives, and priorities; and decreased nonlabor costs, such as travel and services, associated with targeted personnel savings.

Savings From Space Optimization −$76,700,000/0 FTE.—In an effort to promote more efficient use of the Government's real estate assets and to generate savings, the IRS plans to close, consolidate, and reduce its space inventory. In making these decisions, the IRS will consider such factors as the next closest post of duty, number of employees affected, timing of the lease, alteration costs, number of vacant workstations, and number of field-based employees. As part of this effort, the IRS will develop implementation strategies to minimize the effect on employees.

LEGISLATIVE PROPOSALS

The fiscal year 2014 President's budget request includes a number of legislative proposals intended to reduce the tax gap and improve tax compliance with minimal taxpayer burden. The Treasury Office of Tax Analysis (OTA) estimates these new tax gap proposals will generate $77.9 billion over the next 10 years, including $46.5 billion generated by program integrity cap adjustments. The IRS estimates the implementation cost for the tax gap proposals included in the fiscal year 2013 President's budget that have not yet been enacted, to be $84.1 million over 3 years, including the initial startup, processing, and compliance operational costs. The administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

The budget also proposes to amend the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA), as amended, to provide 10 years (fiscal years 2014–2023) of funding to the IRS above discretionary caps for program integrity cap adjustments. The proposal would costs $13.8 billion and delivers $46.5 billion in additional enforcement revenue, thereby generating $32.7 billion in net savings over the 10-year budget window.

CONCLUSION

Mr. Chairman, Ranking Member Johanns, let me thank the subcommittee again for the opportunity to discuss the tax filing season and the fiscal year 2014 budget request for the IRS. We will continue our efforts to be fiscally prudent and make wise investments in strategic priorities in enforcement, service, and business modernization. However, as I have noted, without a change in the current budget environment, the American people will see erosion in our ability to serve them, and the Federal Government will see fewer receipts from our enforcement activities.

PREPARED STATEMENT OF THE INTERNAL REVENUE SERVICE OVERSIGHT BOARD

INTRODUCTION AND EXECUTIVE SUMMARY

The Internal Revenue Service (IRS) Oversight Board welcomes this opportunity to provide the subcommittee with its views and recommendations on the President's fiscal year 2014 budget request for the IRS and the risks and challenges the agency is confronting in today's austere budget environment.

One of the Board's most important statutory responsibilities under 26 U.S.C. § 7802(d) is to review and approve the annual IRS-prepared budget request submitted to the Department of the Treasury. The Board must ensure that the approved budget and related performance expectations:

—support the IRS' mission and annual and long-range strategic plans;

—are consistent with the IRS' goals, objectives and strategies; and

—properly align with the IRS' strategies and plans.

In June 2012, the IRS Oversight Board recommended to the Department of the Treasury a fiscal year 2014 budget of $13.074 billion for the IRS. This is $213.6 million more than what the President put forth in his fiscal year 2014 budget request. After careful examination and deliberation of the President's budget request, the Board believes that the President's recommended level is appropriate for the IRS to carry out its statutory responsibilities.

The IRS' budget has been reduced since fiscal year 2010, with the biggest cuts occurring now in fiscal year 2013 due to the budget sequestration. Although the IRS has sought and implemented cost savings and efficiencies wherever it could, that path is, in the Board's opinion, no longer sustainable. Performance will ultimately suffer. We have already seen the erosion of toll-free telephone level of service and projected lower revenue collection. The effects of the cuts will be even more pronounced in 2014. For every $1 invested in IRS services, enforcement, operations support, and Business Systems Modernization, there is at least a $4-to-$1 return, which translates into more than $4 in additional revenue for every $1 invested in the IRS.

The Board recommends that investments above the current fiscal year 2013 enacted level be made in IRS Taxpayer Services, Enforcement, and Operations Support. The Board's budget does exactly that and does not take funding from one category to bolster another. The Board believes that the IRS' budget must reflect the intent of the IRS Restructuring and Reform Act of 1998 (RRA 98) where both customer service and enforcement are funded at appropriate levels, and not to the detriment of either.

Although slightly lower that what the Board initially recommended, the President's budget request makes targeted investments in the same areas, such as strengthening telephone level of service. The President's budget also has a number of proposed revenue-generating enforcement initiatives that the Board supports which will increase both enforcement revenue and overall compliance. In addition, it provides funding so the IRS can effectively implement new responsibilities, such as the tax portions of the Affordable Care Act (ACA) and merchant credit card and stock basis reporting. Approximately one-half of the $1 billion increase the President seeks for the IRS would be financed by a program integrity cap adjustment. Treasury Secretary Jacob Lew has made a compelling case for this suite of enforcement programs and their average $6-to-$1 return on investment when fully realized. The Board believes these initiatives could play an important role in closing the tax gap, while producing revenues to reduce the deficit and creating funding for other programs that are critical to our Nation and America's taxpayers.

BUDGETARY CHALLENGES

The IRS confronts a number of formidable budgetary challenges. Funding uncertainty and budget cuts loom largest and present the highest risks to the IRS and our Nation's tax administration system. The inability to pass Federal budgets for the past several years has forced the Congress and the administration to increasingly rely on continuing resolutions (CR) to avoid a full or partial Federal Government shutdown, but often at a lower, or stagnant funding level.

Today, the IRS is operating under a continuing resolution, plus sequestration rules, that fund the agency at just under $11.2 billion, well below both the President's and the Board's fiscal year 2013 recommendations. This level is also more than $600 million less than the fiscal year 2011 level, and almost $1 billion less than fiscal year 2010.

Together, these budget cuts have forced the IRS to find major cost efficiencies and implement significant spending cuts. This has led to dramatic curtailments in training, travel, office space and outside contracts. The IRS has also been forced to significantly reduce the size of its workforce. In fiscal year 2012, the agency offered buyouts to 7,000 of its employees, with more than 1,200 accepting. The IRS also instituted an "exception-only" hiring freeze early in fiscal year 2011, leaving most positions lost to attrition unfilled.

All told, approximately 8,000 full-time permanent IRS positions have been lost since 2010, with about 5,000 coming from front-line enforcement personnel. In 2012, the IRS workforce (as measured in average full-time equivalent, or FTE) stood at just under 90,300; its lowest level in more than a decade. That number could go even lower given the large pool of IRS employees now eligible to retire.

The immediate effects of absorbing these budget cuts have been most apparent in customer service, especially during the past two filing seasons when toll-free telephone Level of Service (LOS) hovered around 70 percent—far below the Board's and IRS' desired level of 80 percent. Many IRS Taxpayer Assistance Centers are also understaffed and offer reduced hours and limited tax preparation services.

However, stagnant funding provided through the continuing resolutions was only the beginning of the IRS' funding shortfalls. Today, the IRS' budget has been reduced by a total of $618 million from the $11.8 billion it would have received under the fiscal year 2013 continuing resolution with $594.5 million coming from the sequestration and $24 million in rescission cuts.

The resulting $11.198 billion budget is $1.6 billion less than the President's fiscal year 2013 budget request. This also marks the third consecutive year that the IRS' annual appropriation has declined. Since fiscal year 2010, it has seen reductions to its appropriated funding totaling almost $1 billion.

To meet the mandatory spending cuts for fiscal year 2013 under sequestration, the IRS plans to furlough all employees for 5 to 7 specific days beginning in late May until the end of the fiscal year. All IRS operations will be closed on these uniform dates, including toll-free operations and Taxpayer Assistance Centers.

Although the furloughs will occur after the conclusion of the 2013 filing season, legitimate concerns have been expressed about the sequestration's potential effect on the IRS' long-term performance, especially if more budget cuts continue in the out-years. A continuing budget sequestration will reduce the enforcement revenue the IRS collects. The effects from the budget cuts will also become more apparent as time goes on, with more significant reductions in revenues and performance beginning to show in 2014.

The IRS has already had to adjust its fiscal year 2013 Operating Plan to reflect the sequestration's drain on funding. For example, to apply the employee furloughs evenly across the organization, the IRS proposed to transfer up to $75 million from its Enforcement Appropriation to its Taxpayer Services and Operations Support Appropriations.

The Department of the Treasury asked the Board to review and comment on the IRS Operating Plan. We believe the plan will most likely result in significantly reduced performance results and the erosion of taxpayer service and compliance programs in fiscal year 2013 and future years. It should also be noted that a reduction of this size and scope will most likely impact voluntary compliance and IRS efforts to close the tax gap.

The Board is also concerned that these drastic budget cuts and subsequent staffing reductions come at a time that the IRS is faced with increased responsibilities and workload. For example, administering the tax portions of the ACA presents large challenges in both customer service and enforcement. In fiscal year 2014, the IRS must also implement the merchant card and stock basis matching initiatives and the Foreign Account Tax Compliance Act, all of which will require increased funding and staff. In addition, stolen identity refund fraud continues to be a major problem for tax administration.

Given all these factors, the Oversight Board believes that this is not the time to make shortsighted budget cuts that can erode the many important gains the IRS has achieved since the enactment of RRA 98, including better customer service, an overall increase in enforcement revenue, and success in modernizing major information systems. It is important to restore continuity and make the needed investments in three key areas:

—Taxpayer services;
—Enforcement; and
—Operations support.

IRS OVERSIGHT BOARD BUDGET RECOMMENDATIONS

The President's fiscal year 2014 budget requests $12.861 billion in direct appropriations for the Internal Revenue Service. This represents an 8.8 percent funding increase over the fiscal year 2012 enacted level. However, the budget request is $213.6 million less than the $13.074 billion initially recommended by the Oversight Board for the IRS to meet its statutory responsibilities in fiscal year 2014. The $213 million difference is related primarily to additional savings the IRS has identified in the President's budget. It should be noted that the President's fiscal year 2014 budget request does not reflect the $594 million (5 percent) sequestration and $24 million (0.2 percent) rescission cuts that the IRS had to make in fiscal year 2013. At present, the IRS does not know the impact of sequestration in fiscal year 2014.

Nonetheless, the Board believes that the President's fiscal year 2014 budget request is credible and reasonable. It is aligned with and supports IRS Strategic Plan goals and objectives and Treasury Department priority goals. Moreover, it makes up for much of the loss in resources and FTE over the past few years when the IRS was funded at fiscal year 2012 enacted levels.

The Board also strongly supports a permanent extension of the Streamlined Critical Pay Provision contained in RRA 98. The President's request supports extending this provision through September 30, 2018. The Board has found the provision to be a valuable and effective tool in bringing specialized expertise to IRS initiatives. It has proven to be successful in not only information technology, but also in sophisticated and complex areas of international taxation, such as transfer pricing. The Board recommends the provision's permanent extension.

The Board appreciates that the fiscal year 2014 budget request is but the beginning of a long process that can be affected by a number of other factors, including the larger continuing debate over deficit reduction. However, that should not prevent us from beginning a productive dialogue about how to fund the IRS so it may achieve its mission. Following are more detailed discussions on various budget items.

Investing in Customer Service

Providing taxpayers with quality customer service is an essential part of the IRS' balanced mission and delivers on its strategic goal: "Improve Service to Make Voluntary Compliance Easier." Taxpayers need assistance to navigate and understand a highly complex tax code and file a correct return. Getting it right the first time benefits both taxpayers and the IRS as it helps prevent inadvertent non-compliance and costly and burdensome post-filing actions, such as audits and penalties. In addition to raising its telephone LOS to acceptable levels, fiscal year 2014 also presents a major customer service, outreach and taxpayer education challenge for the IRS as major tax-related portions of the ACA take effect, including those related to health insurance exchanges.

The Board Recommends

The Board strongly supports the President's requests of $2.4 billion for Taxpayer Services in fiscal year 2014. This request includes an additional $177 million to improve taxpayer service and meet increased demand. The Board believes that this funding level is necessary for the IRS to reach the LOS goal of 79 percent stated in the budget request. Otherwise, providing an acceptable LOS will continue to be a challenge for the IRS; one that the Board hopes the Congress will help the IRS overcome for the sake of all taxpayers.

Investing in Enforcement

Enforcement is a top priority in the IRS Strategic Plan. In recent years, the IRS has made some significant achievements and advancements in enforcement, such as the successful Offshore Voluntary Disclosure Programs that not only collected $5 billion in back taxes, penalties and interest but sent a strong deterrence message to those considering illegally hiding income and assets in overseas tax havens. And last year, the IRS managed to maintain and deliver most of its key enforcement priorities, such as audits in the upper-income brackets. However, the IRS still faces a number of enforcement challenges in fiscal year 2014. The IRS must ramp up its efforts to address offshore noncompliance and abusive tax avoidance schemes, and expand its audit coverage of high-wealth individuals and enterprises. And on a broad scale it must increase the overall audit and collection coverage for all taxpayers.

The Board and other observers from both the private and public sectors also question why the approximate $4 to $1 return on investment (ROI) for IRS enforcement activities is not recognized in the budgetary process. These investments pay for themselves many times over. They can deter noncompliance, provide greater revenues to fund essential Government services, and help reduce the deficit and national debt.

The Board Recommends

The Board strongly supports the President's request for $5.67 billion for Enforcement activities in fiscal year 2014. The President's budget request also includes a number of high ROI tax enforcement and compliance initiatives which would receive above-base funding by a program integrity cap adjustment through 2018, with additional cap adjustments to sustain these revenue-producing initiatives from fiscal year 2018 through fiscal year 2023. The $407 million in IRS program integrity cap adjustment funding for fiscal year 2014 will generate more than $1.6 billion in additional annual enforcement revenue, achieving a fiscal year 2016 ROI of $6 to $1. Absent a cap adjustment, these initiatives would go unfunded. The Board believes that the suite of enforcement initiatives funded in the President's budget request represent a strategic and sound approach to effective and fair tax administration. They will help bolster IRS compliance efforts and provide balanced audit coverage rates across taxpayers with expanded coverage of high-wealth individuals and enterprises and partnership entities. However, as earlier discussed, the Board is concerned that some of these high-ROI enforcement initiatives are proposed to be funded via a program integrity cap that has not been provided through the authorization process in recent years. We hope that this year is not a repeat of the past.

Investing in Operations Support

The successful launch of the Customer Account Data Engine (CADE) 2 was a major milestone in the IRS' technology modernization program. It will allow for the retirement of the antiquated legacy system and enabled the IRS to move from a weekly to a daily processing cycle for individual accounts and conveys numerous benefits. In another development, Modernized e-File (MeF) now accepts both individual and corporate returns and processed more than 115 million returns last year.

However, the Board wants to be sure that a sense of complacency does not set in and that funding for future releases of CADE and other IT programs is not reduced or delayed. Such a mindset could affect both customer service and enforcement initiatives, such as producing more web-based applications and driving forward the agency's innovative data analytics program that can expose not only noncompliance but criminal activity, including tax refund fraud.

The risk of complacency is not limited to technology.

The IRS' employees are its greatest asset but are placed at heightened risk during these uncertain budget times. An engaged workforce is essential if the IRS is to function at a high level and deliver on its mission and strategic goals. Last year, the IRS ranked third amongst the 15 largest Federal agencies and departments on an employee engagement scale. However, the Board is concerned that ranking could slip, especially if further staffing reductions take place and the exception-only hiring freeze continues.

The Board Recommends

The Board strongly supports the President's request for $4.48 billion in Operations Support and $300.8 billion in Business Systems Modernization activities in fiscal year 2014.

The President's budget proposal would increase staffing to support a number of enforcement and customer service initiatives previously described. The Board believes that is a wise investment in human capital and could provide the IRS workforce with new career opportunities that have been unavailable for the past 2 years. However, the President's budget also assumes that the IRS will continue to seek efficiencies in personnel and nonlabor costs, including training. And it is not clear whether the exception-only hiring freeze will continue in programs outside of those marked for increased staffing.

Moreover, while the Board believes that the IRS must continue to explore and use more cost-efficient means to deliver training, such as over the IRS intranet, it also wants to be sure that employees receive quality training that may require live interaction with trainers and peers. As previously noted, the Board also recommends a permanent extension of the Streamlined Critical Pay Provision contained in RRA 98.

CONCLUSION

The IRS Oversight Board thanks the subcommittee for this opportunity to present its views and recommendations on the IRS' fiscal year 2014 budget. With at least a $4 to $1 return on investment for the IRS, every $1 invested in the IRS results in more than $4 in additional revenue. That revenue is needed to reduce our national deficit and fund other important programs for our country. Should the IRS receive the full amount requested in the President's budget request for fiscal year 2014, the agency would be positioned to resume its momentum in tackling some of our Nation's most serious challenges in tax administration. However, should the IRS not be properly funded in fiscal year 2014, voluntary compliance will suffer, as will taxpayers who rely on the IRS to help them understand and meet their tax responsibilities.

IRS OVERSIGHT BOARD

[PLEASE NOTE: The following IRS Oversight Board report "Fiscal Year 2014 IRS Budget Recommendation Special Report" and other IRS Oversight Board reports can be found at Web site http://www.treasury.gov/irsob/reports.]

FISCAL YEAR 2014 IRS BUDGET RECOMMENDATION SPECIAL REPORT

This report captures the Board's recommendations to Congress regarding the IRS Fiscal Year 2014 budget, a budget that is in line with the strategic goals and strategic foundations identified in the *IRS Strategic Plan*:

—*Goal 1:* Improve service to make voluntary compliance easier
—*Goal 2:* Enforce the law to ensure everyone meets their obligations to pay taxes
—*Strategic Foundations:* Invest for high performance in people and technology

IRS OVERSIGHT BOARD ROLES AND RESPONSIBILITIES AND THE IRS BUDGET

One of the IRS Oversight Board's most important statutory responsibilities under 26 U.S.C. § 7802(d) is to review and approve the annual IRS-prepared budget request submitted to the Department of the Treasury. The Board must ensure that the approved budget and related performance expectations: (1) support the IRS' mission and annual and long-range strategic plans; (2) are consistent with the IRS' goals, objectives and strategies; and (3) properly align with the IRS' strategies and plans.

The President is required to submit the Board's budget recommendation without revision to Congress along with the Administration's request. Additionally, the Government Performance and Results Act (GPRA) spells out the agency's responsibilities for linking its strategic, budget and performance plans and reporting to a comprehensive strategic process.

The IRS Oversight Board would also like to note that this year marks the 10th anniversary of the Board's budget recommendation special reports. Much has changed over the past decade when it comes to IRS programs and funding, including an equal emphasis on Taxpayer Services as well as enforcement and the removal of the IRS Business Systems Modernization (BSM) program from the Government Accountability Office's "High Risk" list. Nevertheless, some of the Board's concerns raised in that first budget report still ring true today, such as the need to provide reliable and adequate funding to the IRS so it may achieve a high level of customer service, to address non-compliance, and to enhance information technology systems.

EXECUTIVE SUMMARY

In June 2012, the IRS Oversight Board recommended to Treasury a Fiscal Year 2014 budget of $13.074 billion for the Internal Revenue Service. This is $213.6 million more than what the President put forth in his fiscal year 2014 budget request. After careful examination and deliberation, the Board believes the President's recommended funding is appropriate for the IRS to carry out both its statutory and additional new responsibilities.

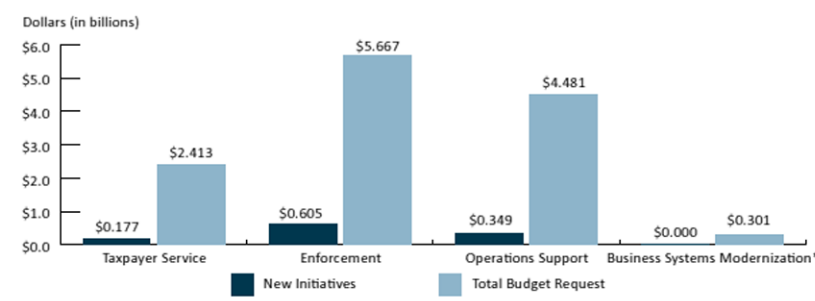
The IRS' budget has been reduced since fiscal year 2010, with the biggest reductions coming in fiscal year 2013 through the sequestration. Although the IRS has achieved significant cost savings and efficiencies in recent years through substantial cuts in program support and IRS staffing, this path is no longer sustainable. While many factors impact IRS performance, such as the state of the economy, there are already indications that the reductions in IRS budgets funding through fiscal year 2012 are leading to a deterioration in performance. The amount of enforcement revenue collected, the level of service on the IRS toll-free assistance line, and measures of taxpayer satisfaction with the IRS and of IRS employee engagement are all down in fiscal year 2012 compared to where these results stood in fiscal year 2010. The effects on the cuts will likely be even more pronounced in fiscal year 2014.

The Board believes the President's recommended funding of $12.8 billion for Fiscal Year 2014 is appropriate for the IRS to carry out its responsibilities.

The Board recommends that investments above the current fiscal year 2013 enacted level be made in Taxpayer Service, Enforcement, and Operations Support. The Board's budget does that and does not take funding from one category to bolster another.

FIGURE 1.

President's FY2014 IRS Budget Request as Supported by the IRS Oversight Board



* While no new initiative funding for BSM is being requested for FY2014, continuation of the existing BSM funding level is critical to continuing the progress in replacing IRS' antiquated master file system and other outdated technology.

The Board believes that the IRS' budget must reflect the intent of the *IRS Restructuring and Reform Act of 1998* (RRA 98) where both taxpayer service and enforcement are funded at appropriate levels, and not to the detriment of either.

Why Should the IRS Receive the Cap Adjustment?

The IRS estimates the requested cap adjustment funding will generate more than $1.6 billion in additional annual direct enforcement revenue beginning in fiscal year 2016, for a return on investment of $6-to-$1. Increased resources for IRS enforcement programs yield measurable results that help reduce the deficit, close the tax gap, and generate revenue for the United States.

Although slightly lower than what the Board initially recommended, the President's budget request makes significant investments in the same areas, such as strengthening telephone level of service. The President's budget also has a number of proposed revenue-generating enforcement initiatives that the Board supports which will increase both enforcement revenue and overall compliance. In addition, it provides funding so the IRS can effectively implement new responsibilities, such as the tax portions of the Affordable Care Act (ACA) and merchant credit card and stock basis reporting.

PROGRAM INTEGRITY CAP ADJUSTMENT

The *Budget Control Act of 2011* imposed caps on discretionary spending by Federal agencies including the IRS. Recognizing that certain activities generate rates of return greater than their respective investment costs, Congress created a budgetary mechanism to increase spending allocations for programs that generate positive new revenue and remove them from competition against other national funding priorities. These allocations are referred to as program integrity cap adjustments.

The IRS is requesting approximately $412,000,000 in high-return initiatives through program integrity cap adjustments as outlined below:

REQUESTED FUNDING AMOUNT FOR PROGRAM INTEGRITY CAP ADJUSTMENT INITIATIVES

[Dollars in thousands]

Address International and Offshore Compliance Issues	$49,354
Increase Audit Coverage to Address Tax Compliance Issues	110,935
Increase Collection Coverage	60,474
Expand Coverage of High-Wealth Individuals and Enterprises	33,965
Improve Coverage of Partnerships and Flow-Through Entities	45,013
Build Out Tax Return Preparer Compliance Activities	18,315
Leverage Data to Improve Case Selection	41,353
Leverage Digital Evidence for Criminal Investigation	4,539
Develop New Online Services	24,059
Develop Converged Telecommunications Networks	15,000
Expand Virtual Services Delivery	3,983
Alcohol and Tobacco Tax and Trade Bureau Transfer	5,000
Total	411,990

For every dollar invested in IRS services, enforcement, operations support, and Business Systems Modernization, there is an average $4-to-$1 return.

Approximately one-half of the one billion dollar increase the President seeks for the IRS would be financed by a program integrity cap adjustment. Treasury Secretary Jacob Lew has made a compelling case for this suite of enforcement programs and their average $6-to-$1 return on investment when fully realized. The Board believes these initiatives could play an important role in closing the tax gap while producing revenues to reduce the deficit and creating funding for other programs that are critical to our Nation.

IRS BUDGET CHALLENGES

The IRS confronts a number of formidable budgetary challenges. Funding uncertainty and budget cuts loom largest and present the highest risks to the IRS and our Nation's tax administration system. The inability to pass Federal budgets for the past several years has forced Congress and the Administration to increasingly rely on Continuing Resolutions (CR) to avoid a full or partial Federal Government shutdown, but often at a lower, or stagnant funding level.

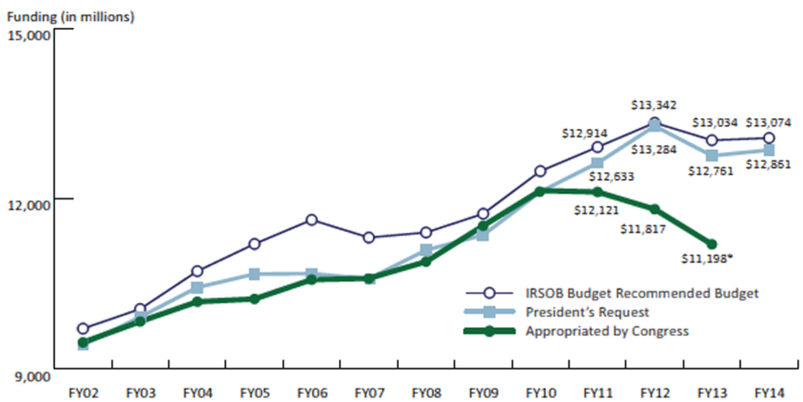
Today, the IRS is operating under a CR, plus sequestration rules, that fund the agency at just under $11.2 billion, well below both the President's and the Board's fiscal year 2013 recommendations. This level is also more than $600 million less than the fiscal year 2012 level, and almost $1 billion less than fiscal year 2010.

Together, these budget cuts have forced the IRS to find major cost efficiencies and implement significant spending cuts. This has led to dramatic curtailments in training, travel, office space and outside contracts. The IRS has also been forced to significantly reduce the size of its workforce. In fiscal year 2012, the agency offered buyouts to 7,000 of its employees, with more than 1,200 accepting. The IRS also instituted an "exception-only" hiring freeze leaving many positions lost to attrition unfilled.

Today, the IRS is operating under a continuing resolution, plus sequestration rules, that fund the agency at the level of just under $11.2 billion, well below both the President's and the Board's FY2013 recommendations. This level is less than $600 million than the FY2012 level, and $1 billion less than FY2010.

FIGURE 2.

IRS Funding History, FY2002-2014

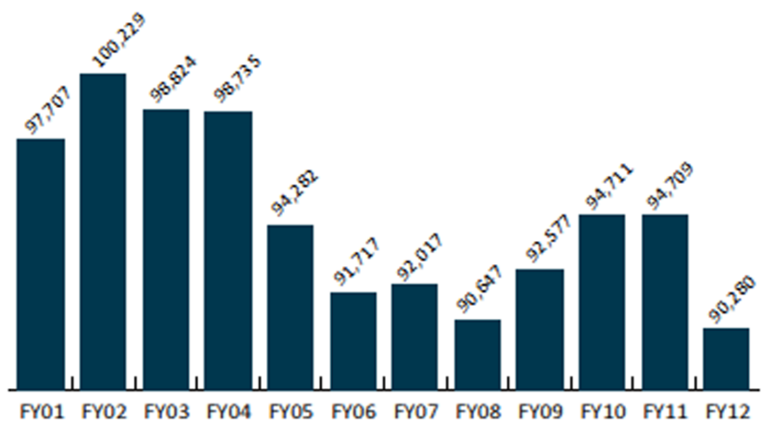


All told, approximately 8,000 full-time IRS positions have been lost since 2010, with about 5,000 coming from front-line enforcement personnel. In 2012, the IRS workforce (as measured in average full-time equivalent positions realized, or FTE) stood at just under 90,300; its lowest level in more than a decade. That number could go even lower given the large pool of IRS employees now eligible to retire.

In 2012, the IRS workforce (as measured in average full-time equivalent positions realized—FTE) stood at just under 90,300; its lowest level in more than a decade.

FIGURE 3.

Number of Full-Time Equivalents, FY2001-2014



Source: IRS Data Book

The immediate effects of absorbing these budget cuts have been most apparent in Taxpayer Services, especially during the past two filing seasons when toll-free telephone Level of Service (LOS) hovered around 70 percent—far below the Board's and IRS' desired level of 80 percent. Many IRS Taxpayer Assistance Centers are also understaffed and offer reduced hours and limited tax preparation services.

Stagnant funding provided through the CRs was only the beginning of the IRS' funding shortfalls. Today, the IRS' budget has been reduced by a total of $618 million from the $11.8 billion it would have received under the fiscal year 2013 Continuing Resolution with $594.5 million coming from the sequestration and $24 million in rescission cuts.

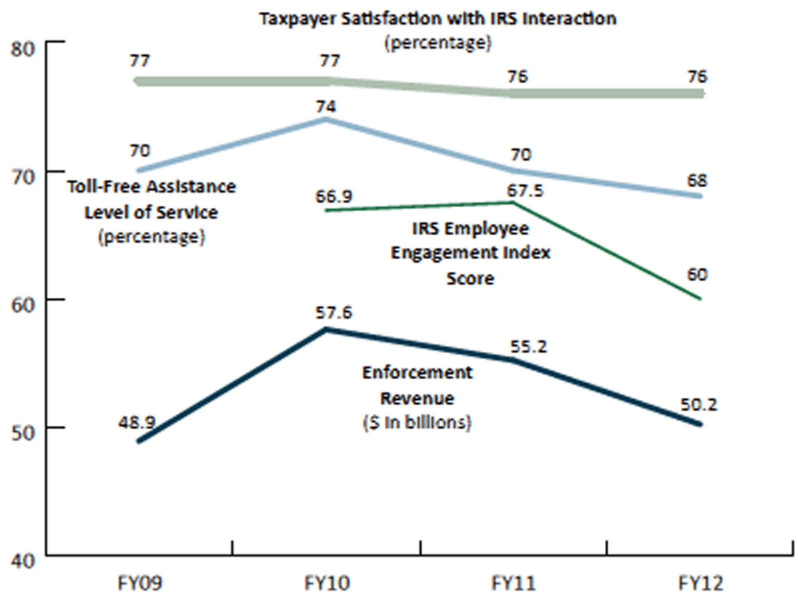
The resulting $11.198 billion budget is $1.6 billion less than the President's fiscal year 2013 budget request. This also marks the third consecutive year that the IRS' annual appropriation has declined. Since fiscal year 2010, it has seen reductions to its appropriated funding totaling almost $1 billion.

To meet the mandatory spending cuts for fiscal year 2013 under sequestration, the IRS plans to furlough all employees for 5 to 7 specific days beginning in late May until the end of the fiscal year. All IRS operations will be closed on these uniform dates, including toll-free operations and Taxpayer Assistance Centers.

Although the furloughs will occur after the conclusion of the 2013 filing season, legitimate concerns have been expressed about the sequestration's potential effect on the IRS' long-term performance, especially if more budget cuts continue in the out-years. The Board notes there are already signs of declining performance in key areas, as indicated in Figure 4. A continuing budget sequestration will reduce the enforcement revenue the IRS collects. The effects from the budget cuts will likely become more apparent as time goes on, with more significant reductions in revenues and performance beginning to show in 2014.

FIGURE 4.

Recent Indicators of Declining Performance in Key Measures, FY2009-2012



Source: IRS Oversight Board Taxpayer Attitude Survey, IRS Enforcement and Services results, and the Federal Employee Viewpoint surveys

The IRS has already had to adjust its fiscal year 2013 Operating Plan to reflect the sequestration's drain on funding. For example, to apply the employee furloughs evenly across the organization, the IRS proposed to transfer up to $75 million from its Enforcement Appropriation to its Taxpayer Services and Operations Support Appropriations.

The Department of the Treasury asked the Board to review and comment on the IRS Operating Plan. We believe the plan will most likely result in significantly reduced performance results and the erosion of taxpayer service and compliance programs in fiscal year 2013 and future years. It should also be noted that a reduction of this size and scope will most likely impact voluntary compliance and IRS efforts to close the tax gap.

The Board is also concerned that these drastic budget cuts and subsequent staffing reductions come at a time that the IRS is faced with increased responsibilities and workload. For example, administering the tax portions of the ACA presents large challenges in both taxpayer service and enforcement. In fiscal year 2014, the IRS must also leverage the merchant card and stock basis matching initiatives and the Foreign Account Tax Compliance Act, all of which will require increased funding and staff. In addition, stolen identity refund fraud continues to be a major problem for tax administration.

Given all these factors, the Oversight Board believes that this is not the time to make shortsighted budget cuts that can erode the many important gains the IRS has achieved since the enactment of RRA 98, including better taxpayer service, an overall increase in enforcement revenue, and success in modernizing major information systems. It is important to restore continuity and make the needed investments in three key areas: (1) Taxpayer Services; (2) Enforcement; and (3) Operations Support.

PRESIDENT'S FISCAL YEAR 2014 IRS BUDGET REQUEST AND IRS OVERSIGHT BOARD RECOMMENDATIONS

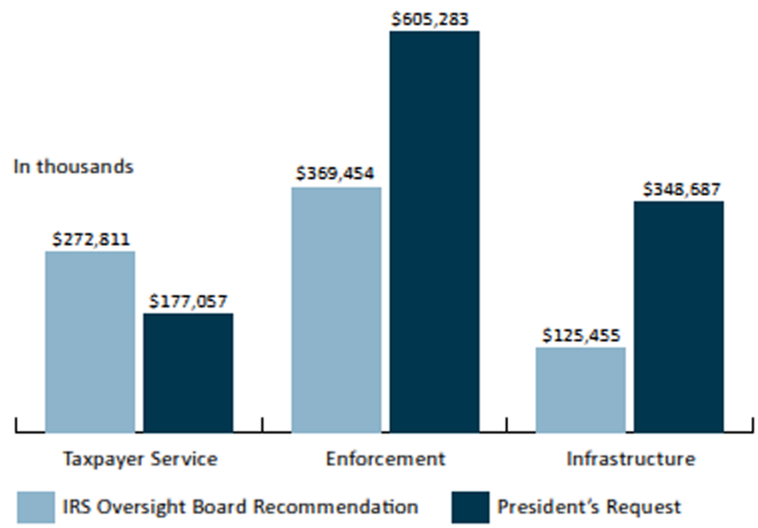
The President's fiscal year 2014 budget requests $12.861 billion in direct appropriations for the Internal Revenue Service. This represents an 8.8 percent funding increase over the fiscal year 2012 enacted level. However, the budget request is $213.6 million below the $13.074 billion initially recommended by the Oversight Board for the IRS to meet its statutory responsibilities. The $213 million difference in the President's request is related primarily to additional savings the IRS identified.

The President's 2014 budget further requires that the IRS achieve efficiencies and savings of $254.8 million from the following:

—*Targeted Personnel*.—$77.8 million
—*Space Optimization Savings*.—$76.7 million
—*Reduce IT Infrastructure*.—$57.5 million
—*Business System Modernization (BSM)*.—$30 million
—*Implement Human Capital Efficiencies*.—$7.9 million
—*Increase e-File Savings*.—$5 million

FIGURE 5.

FY2014 IRS Oversight Board Initial Request and President's Budget Request for Initiatives



It should be noted that the President's fiscal year 2014 budget request does not reflect the $594 million (5 percent) sequestration and $24 million (0.2 percent) rescission cuts that the IRS had to make in fiscal year 2013. At present, the IRS does not know the impact of sequestration in fiscal year 2014. The Board assumes no sequestration will be in effect in fiscal year 2014.

Nonetheless, the Board believes that the President's fiscal year 2014 Budget Request is credible and reasonable. It is aligned with and supports IRS Strategic Plan goals and objectives and Treasury Department priority goals. Moreover, it makes up for much of the loss in resources and FTE over the past few years when the IRS was funded at fiscal year 2012 enacted levels.

The Board also strongly supports a permanent extension of the Streamlined Critical Pay Provision contained in RRA 98. The President's request supports extending this provision through September 30, 2018. The Board has found the provision to be a valuable and effective tool in bringing specialized expertise to IRS initiatives. It has proven to be successful in not only information technology, but also in sophisticated and complex areas of international taxation, such as transfer pricing. The Board recommends the provision's permanent extension.

The Board appreciates that the fiscal year 2014 budget request is but the beginning of a long process that can be affected by a number of other factors, including the larger continuing debate over deficit reduction. However, that should not prevent us from beginning a productive dialogue about how to fund the IRS so it may achieve its mission. Following are more detailed discussions on various budget items.

The Board believes that Streamlined Critical Pay is vital to the IRS' ability to attract leaders with cutting edge skills and talent for key positions.

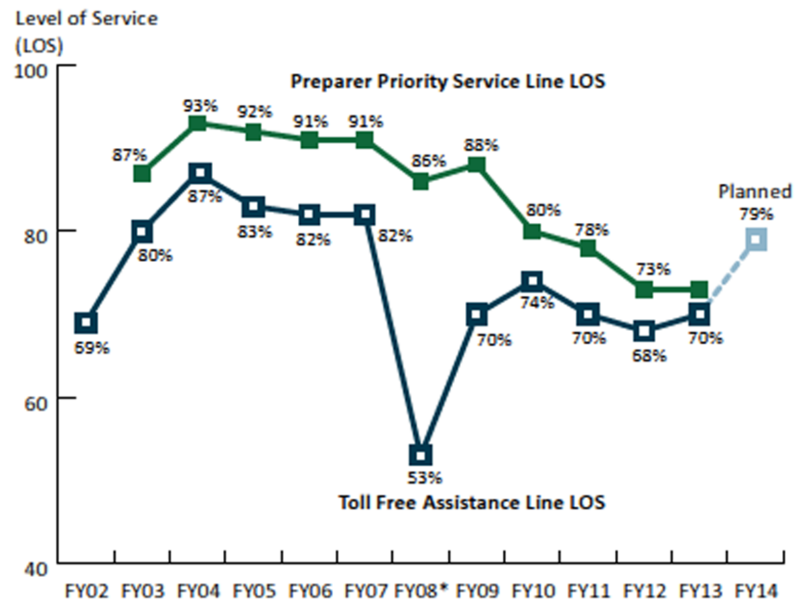
TAXPAYER SERVICES

Providing taxpayers with quality taxpayer service is an essential part of the IRS' balanced mission and delivers on its strategic goal: "Improve Service to Make Voluntary Compliance Easier." Taxpayers need assistance to navigate and understand a highly complex tax code and file a correct return. Getting it right the first time benefits both taxpayers and the IRS as it helps prevent inadvertent non-compliance and costly and burdensome post-filing actions, such as audits and penalties. Figure 6 shows the dramatic decline in telephone assistance and practitioner priority service levels over the past decade. In addition to raising its telephone LOS to acceptable levels, fiscal year 2014 also presents a major taxpayer service, outreach and taxpayer education challenge for the IRS as major tax-related portions of the ACA take effect, including those related to health insurance exchanges.

The Board strongly supports the President's request for $2.41 billion for Taxpayer Services in fiscal year 2014 and believes the President's funding level is necessary to raise IRS telephone level of service and to educate taxpayers on ACA tax-related provisions.

FIGURE 6.

Toll Free and Preparer Priority Lines: Level of Service



*Toll free LOS dropped dramatically in 2008 due to a near doubling of calls from inquiries concerning the unique, one-time only IRS issuance of economic stimulus checks.

Source: IRS Enforcement and Service Results report and IRS reports to Board Operations Committee

What the Board Recommends

The Board strongly supports the President's request of $2.41 billion for Taxpayer Services in fiscal year 2014, This request includes an additional $177 million to improve taxpayer service and meet increased demand. The Board believes that this funding level is necessary for the IRS to reach the LOS goal of 79 percent stated in the budget request. Otherwise, providing an acceptable LOS will continue to be a challenge for the IRS; one that the Board hopes the Congress will help the IRS overcome for the sake of all taxpayers.

The Board strongly supports the President's request for $5.67 billion for Enforcement activities in fiscal year 2014 and believes that the enforcement initiatives represent a sound, strategic approach to effective and fair tax administration.

ENFORCEMENT

Enforcement is a top priority in the IRS Strategic Plan. In recent years, the IRS has made some significant achievements and advancements in enforcement, such as the successful Offshore Voluntary Disclosure Programs that not only collected $5 billion in back taxes, penalties and interest but sent a strong deterrence message to those considering illegally hiding income and assets in overseas tax havens. Last year, the IRS managed to maintain and deliver most of its key enforcement priorities, such as audits in the upper-income brackets. However, the IRS still faces a number of enforcement challenges in fiscal year 2014. The IRS must ramp up its efforts to address offshore non-compliance and abusive tax avoidance schemes and expand its audit coverage of high-wealth individuals and enterprises. On a broad scale it must also increase the overall audit and collection coverage for all taxpayers.

The Board and other observers from both the private and public sectors also question why the approximate $4-to-$1 return on investment (ROI) for IRS enforcement activities is not recognized in the budgetary process. These investments pay for themselves many times over. They can deter noncompliance, provide greater revenues to fund essential Government services, and help reduce the deficit and national debt.

What the Board Recommends

The Board strongly supports the President's request for $5.67 billion for Enforcement activities in fiscal year 2014. The President's budget request also includes a number of high ROI tax enforcement and compliance initiatives which would receive above-base funding by a program integrity cap adjustment through 2018, with additional cap adjustments to sustain these revenue-producing initiatives from fiscal year 2018 through fiscal year 2023. The $407 million in IRS program integrity cap adjustment funding for fiscal year 2014 will generate more than $1.6 billion in additional annual enforcement revenue, achieving a potential ROI of $6.0-to-$1.0 in fiscal year 2016. Absent a cap adjustment, these initiatives would go unfunded. Table 1 identifies the ROI on each enforcement initiative.

The program integrity cap adjustment funding for fiscal year 2014 will generate more than $1.6 billion in additional annual enforcement revenue, achieving a potential ROI of $6.0-to-$1.0 in fiscal year 2016. Absent a cap adjustment, these initiatives would go unfunded.

TABLE 1.—ESTIMATED RETURN ON INVESTMENT FOR RECOMMENDED ENFORCEMENT INITIATIVES

Initiatives	Recommended Funding (Note 1)	Fiscal Year 2016 Return on Investment
Program Increases Before Cap Adjustment		
Improve Identification and Prevention of Refund Fraud and Identity Theft	$101,098	$14.4 to $1
Implement Merchant Card and Basis Matching	50,279	8.5 to 1
Implement Foreign Account Tax Compliance Act (FATCA)	35,190	3.7 to 1
Address Impact of Affordable Care Act (ACA) Statutory Requirements	44,420	1.9 to 1
Leverage Data to Improve Case Selection (Taxpayer Services portion)	10,348	Note 2
Additional Program Increases After Cap Adjustment		
Expand Coverage of High-Wealth Individuals and Enterprises	33,965	13.4 to 1
Increase Collection Coverage	60,474	9.3 to 1
Improve Coverage of Partnerships and Flow-Through Entities	45,013	7.7 to 1
Address International and Offshore Compliance Issues	49,354	4.5 to 1
Increase Audit Coverage to Address Tax Compliance Issues	110,935	3.2 to 1
Leverage Data to Improve Case Selection	41,353	1.5 to 1
Build Out Tax Return Preparer Compliance Activities	18,315	Note 2
Leverage Digital Evidence for Criminal Investigation	4,539	Note 2

Note 1: Dollars in thousands.
Note 2: While these initiatives do not have an immediate ROI associated with them, they provide long-term benefits to the IRS such as significantly increasing the availability and use of electronic data in case work.

The Board believes that the suite of enforcement initiatives funded in the President's budget request represent a strategic and sound approach to effective and fair tax administration. They will help bolster IRS compliance efforts and provide balanced audit coverage rates across taxpayers with expanded coverage of high-wealth individuals and enterprises and partnership entities. However, as earlier discussed, the Board is concerned that some of these high-ROI enforcement initiatives are proposed to be funded via a program integrity cap that has not been provided through the authorization process in recent years. We hope that this year is not a repeat of the past.

The Board strongly supports the President's request for $4.48 billion in Operations Support and $300.8 billion in Business Systems Modernization activities in fiscal year 2014 and believes that funding for future IT programs should not be reduced or delayed.

OPERATIONS SUPPORT AND BUSINESS SYSTEMS MODERNIZATION

The successful launch of the Customer Account Data Engine (CADE) 2 was a major milestone in the IRS' technology modernization program. It will allow for the retirement of the antiquated legacy system and enable the IRS to move from a weekly to a daily processing cycle for individual accounts, which conveys numerous benefits. In another development, Modernized e-File systems now accept both individual and corporate returns and processed over 115 million returns last year.

However, the Board wants to be sure that a sense of complacency does not set in and that funding for future releases of CADE and other IT programs is not reduced or delayed. The risk of complacency is not limited to technology.

The IRS' employees are its greatest asset but are placed at heightened risk during these uncertain budget times. An engaged workforce is essential if the IRS is to function at a high level and deliver on its mission and strategic goals. Last year, the IRS ranked third amongst the 15 largest Federal agencies and departments on an employee engagement scale. However, the Board is concerned that ranking could slip, especially if further staffing reductions take place and the exception-only hiring freeze continues.

What the Board Recommends

The Board strongly supports the President's request for $4.48 billion in Operations Support and $300.8 billion in Business Systems Modernization activities in fiscal year 2014.

The President's budget proposal would increase staffing to support a number of enforcement and taxpayer service initiatives previously described. The Board believes that is a wise investment in human capital and could provide the IRS workforce with new career opportunities that have been unavailable for the past 2 years. However, the President's budget also assumes that the IRS will continue to seek efficiencies in personnel and non-labor costs, including training. It is not clear whether the exception-only hiring freeze will continue in programs outside of those marked for increased staffing.

> *The President's budget request increases IRS staffing to support several enforcement and taxpayer service initiatives. The Board believes it is a wise investment in human capital and the workforce.*

Moreover, while the Board believes that the IRS must continue to explore and use more cost-efficient means to deliver training, such as over the IRS intranet, it also wants to be sure that employees receive quality training that may require live interaction with trainers and peers. As previously noted, the Board also recommends a permanent extension of the Streamlined Critical Pay Provision contained in RRA 98.

APPENDIX A

IRS OVERSIGHT BOARD INITIAL RECOMMENDED FISCAL YEAR 2014 BUDGET

[Dollars in thousands]

Fiscal Year 2012 Enacted Budget	11,816,696
Fiscal Year 2013 Adjusted Base Request/Annualized Continuing Resolution (CR) Rate	12,304,750
Fiscal Year 2014 Changes to Base	
Maintaining Current Levels	112,548
Efficiencies/Savings	(140,381)
Reinvestment	30,000
Subtotal, Fiscal Year 2014 Changes to Base	2,167
Fiscal Year 2014 Current Services (Base)	12,306,917
Program Increases	
Taxpayer Services Initiatives	272,811
Improve Taxpayer Services to Meet Increased Demand	162,720
Develop New Online Services	24,059
Assist Taxpayers in Understanding ACA Tax Issues	79,128
Expand Virtual Services Delivery (VSD)	4,300
Expand Low Income Taxpayer Clinics	2,604

IRS OVERSIGHT BOARD INITIAL RECOMMENDED FISCAL YEAR 2014 BUDGET—Continued

[Dollars in thousands]

Enforcement Initiatives	369,454
Address International and Offshore Compliance Issues	84,544
Implement Merchant Card and Basis Matching	50,279
Improve Identification and Prevention of Refund Fraud and Identity Theft	96,455
Expand Coverage of HIgh-Wealth Individuals and Enterprises	18,607
Improve Coverage of Partnerships and Flow-Through Entities	45,014
Build Out Tax Return Preparer Compliance Activities	18,315
Leverage Data to Improve Case Selection	51,701
Leverage Digital Evidence for Criminal Investigation (CI)	4,539
Infrastructure Initiatives	125,455
Implement IT Changes to Deliver Tax Credits and Other Requirements	102,255
Implement IT Changes Needed for Individual Coverage Requirements	8,200
Develop Converged Telecommunication Networks	15,000
Total Fiscal Year 2013 Program Changes	768,435
Total Fiscal Year 2014 Budget Recommendation	13,074,637
Fiscal Year 2014 President's Budget Request	12,861,033
Increase over President's Budget	213,604
Percent Increase over President's Budget	1.6%

This table presents the fiscal year 2014 IRS funding and initiatives initially proposed by the Oversight Board in June 2012. The table also identifies the overall funding difference between the Board's initial proposal and the President's request. Note that in developing its fiscal year 2014 IRS budget recommendation in June 2012, the Board started with an assumed fiscal year 2013 adjusted base of $12.3 billion (along with an associated set of initiatives being funded in fiscal year 2013, which was in line with the Federal budget preparation process at that time.)

Appendix B

IRS FISCAL YEAR 2014 BUDGET HIGHLIGHTS BEFORE AND AFTER CAP ADJUSTMENT

[Dollars in thousands]

Appropriation	Taxpayer Services	Enforce-ment	Operations Support	BSM	Total
Fiscal Year 2012 Enacted [1]	2,239,703	5,299,367	3,947,416	330,210	11,816,696
Fiscal Year 2013 Annualized CR Rate	2,253,510	5,331,000	3,971,000	332,231	11,887,741
Fiscal Year 2014 Changes to Base:					
Non-Recur CR Increase	(13,807)	(31,633)	(23,584)	(2,021)	(71,045)
Maintaining Current Levels (MCLs)	22,391	50,551	52,115	617	125,674
Pay Inflation Adjustment	19,277	45,802	13,977	617	79,673
Non-Pay Inflation Adjustment	3,114	4,749	38,138	....	46,001
Efficiencies/Savings:	(18,208)	(56,605)	(150,051)	(30,000)	(254,864)
Increase e-File Savings	(4,969)	....	(71)	....	(5,040)
Business Systems Modernization (BSM) Savings	....	....	....	(30,000)	(30,000)
Reduce Information Technology (IT) Infrastructure	....	....	(57,500)	....	(57,500)
Implement Human Capital Administrative Efficiencies	....	....	(7,858)	....	(7,858)
Targeted Personnel Savings	(13,239)	(56,605)	(7,922)	....	(77,766)
Savings from Space Optimization	....	....	(76,700)	....	(76,700)
Reinvestment:	....	....	37,500	....	37,500
Implement Space Optimization to Achieve Savings	....	....	37,500	....	37,500
Subtotal Fiscal Year 2014 Changes to the Base	(9,624)	(37,687)	(84,020)	(31,404)	(162,735)
Fiscal Year 2014 Current Services (Base)	2,243,886	5,293,313	3,886,980	300,827	11,725,006
Program Changes					
Program Increases Before Cap Adjustment:					
Promote Voluntary Compliance, Implement Legislative Changes, and Protect Revenue	168,690	127,570	427,777	....	724,037
Improve Taxpayer Services and Meet Increased Demand	130,306	3,250	43,501	....	177,057
Implement Foreign Account Tax Compliance Act (FATCA)	....	19,600	15,590	....	35,190
Implement Merchant Card and Basis Matching	7,643	30,275	12,361	....	50,279
Address Impact of Affordable Care Act (ACA) Statutory Requirements	1,124	26,084	17,212	....	44.420
Implement IT Changes to Deliver Tax Credits and Other Requirements	....	....	305,645	....	305,645
Improve Identification and Prevention of Refund Fraud and Identity Theft	19,269	48,361	33,468	....	101,098
Leverage Data to Improve Case Selection (Taxpayer Services portion)	10,348	....	....	....	10,348
Total Request Before Cap Adjustment	2,412,576	5,420,883	4,314,757	....	12,449,043
Cap Adjustment Program Increases					
Enforcement Initiatives	....	240,904	123,044	....	363,948
Address International and Offshore Compliance Issues	....	43,311	6,043	....	49,354
Increase Audit Coverage to Address Tax Compliance Issues	....	71,453	39,482	....	110,935
Increase Collection Coverage	....	36,261	24,213	....	60,474
Expand Coverage of High-Wealth Individuals and Enterprises	....	29,456	4,509	....	33,965
Improve Coverage of Partnerships and Flow-Through Entities	....	39,136	5,877	....	45,013
Build Out Tax Return Preparer Compliance Activities	....	15,982	2,333	....	18,315
Leverage Data to Improve Case Selection	....	4,474	36,879	....	41,353
Leverage Digital Evidence for Criminal Investigation (CI)	....	831	3,708	....	4,539
Infrastructure Initiatives	....	....	43,042	....	43,042
Develop New Online Services	....	....	24,059	....	24,059
Develop Converged Telecommunications Networks	....	....	15,000	....	15,000
Expand Virtual Services Delivery (VSD)	....	....	3,983	....	3,983
Alcohol and Tobacco Tax and Trade Bureau (TTB) Program Integrity Transfer	....	5,000	....	....	5,000
Transfer to TTB for High-Return on Investment (ROI) Tax Enforcement Activities	....	5,000	....	....	5,000

IRS FISCAL YEAR 2014 BUDGET HIGHLIGHTS BEFORE AND AFTER CAP ADJUSTMENT—Continued

[Dollars in thousands]

Appropriation	Taxpayer Services	Enforce-ment	Operations Support	BSM	Total
Subtotal Fiscal Year 2014 Cap Adjustment	....	245,904	166,086	....	411,990
Total Fiscal Year 2014 Budget Request	2,412,576	5,666,787	4,480,843	300,827	12,861,033

Source: U.S. Treasury Budget in Brief.

PREPARED STATEMENT OF THE GOVERNMENT ACCOUNTABILITY OFFICE

MAY 3, 2013.

Hon. FRANK LAUTENBERG, *Chairman*,
Hon. MIKE JOHANNS, *Ranking Member*,
Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate, Washington, DC.

Hon. CHARLES W. BOUSTANY, JR., *Chairman*,
Hon. JOHN LEWIS, *Ranking Member*,
Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, DC.

Internal Revenue Service: Preliminary Observations on the Fiscal Year 2014 Budget Request

This letter transmits briefing slides based on our work to date in response to your requests for a preliminary review of the fiscal year 2014 budget request for the Internal Revenue Service (IRS). See appendix I and appendix II for the briefing slides that include the information used to brief your staff in April 2013, and were subsequently updated.

Our briefing objectives were to (1) describe the fiscal year 2013 budget for IRS and potential reductions resulting from sequestration; (2) describe IRS's budget data and trends from fiscal years 2010 through 2014 and the fiscal year 2014 new program initiatives, return on investment (ROI) information, and major information technology (IT) investments; (3) list any analyses we have done related to legislative proposals highlighted in the congressional budget justification; and (4) identify our open matters for Congress and recommendations to IRS with a potential financial benefit.

To conduct this work, we summarized the President's budgets and IRS congressional budget justifications from fiscal years 2010 through 2014, reviewed Office of Management and Budget guidance on sequestration, reviewed revenue estimates from the Department of Treasury's Green Book, and interviewed IRS officials in the offices of the Chief Financial Officer and Corporate Budget. We interviewed IRS officials and determined that the data presented in this briefing were sufficiently reliable for our purposes.

We conducted this performance audit from April to May 2013 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.

In summary:

—The fiscal year 2013 annualized continuing resolution rate shown in the fiscal year 2014 budget ($11.9 billion) is not the enacted funding level, and the actual amount is $689 million lower.

—For fiscal year 2014, the President's budget requests an increase for IRS of 9 percent ($1,044 million) in discretionary funding over the fiscal year 2012 appropriation and an increase of 8 percent (6,732 full-time equivalents) in staffing over fiscal year 2012 actual levels. In addition, the funding request includes:

  —Twelve new program initiatives related to enforcement activities and six new program initiatives related to taxpayer service, infrastructure, or other activities.

  —New information on actual return on investment for enforcement activities, and expanded information on IT investments, such as lifecycle costs, projected useful life of the current asset, and anticipated benefits.

—The request includes 33 legislative proposals, including 12 related to our prior work.

—As of March 2013, 39 of our products contained 10 matters for congressional consideration and 88 recommendations to IRS with a potential financial benefit that have not been addressed. Since March 2012, IRS has implemented 24 recommendations with a potential financial benefit. See appendix III for a complete listing of all 39 products.

Agency Comments

On May 1, 2013, IRS provided technical comments on our findings, which we have incorporated where appropriate.

As arranged with your office, unless you publically announce the contents of this report earlier, we plan no further distribution until 5 days after the date of this report. At that time, we will send copies of this report to other Chairmen and Ranking Members of Senate and House committees and subcommittees that have appropriation and oversight responsibilities for IRS. We also will be sending copies to the Acting Commissioner of Internal Revenue, the Secretary of the Treasury, and the Chairman of the IRS Oversight Board. Copies also are available at no charge on the GAO website at http://www.gao.gov.

If you or your staffs have any questions about this report, please contact us at mctiguej@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs are Katherine Siggerud, Managing Director, Congressional Relations at siggerudk@gao.gov, and Chuck Young, Managing Director, Public Affairs at youngc1@gao.gov. GAO staff members who made major contributions to this report are listed in appendix IV.

Sincerely yours,

JAMES R. MCTIGUE, JR.,
Director, Tax Issues, Strategic Issues.

APPENDIX I: BRIEFING SLIDES

INTERNAL REVENUE SERVICE: PRELIMINARY OBSERVATIONS ON THE FISCAL YEAR 2014 BUDGET REQUEST

Prepared for the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives (April 23, 2013) and the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate (April 25, 2013).

Updated May 3, 2013.

BRIEFING OBJECTIVES

You requested preliminary information on the fiscal year 2014 budget for IRS. This briefing:

—describes the fiscal year 2013 budget for IRS and potential reductions resulting from sequestration;

—describes IRS's budget data and trends from fiscal years 2010 through 2014, and the fiscal year 2014 new program initiatives, return on investment (ROI) information, and major information technology (IT) investments;

—lists any analyses we have done related to legislative proposals highlighted in the congressional budget justification; and

—identifies our open matters for Congress and recommendations to IRS with a potential financial benefit.

SCOPE AND METHODOLOGY

To conduct this work, for each objective, we:

—summarized the President's budgets and IRS congressional justifications from fiscal years 2010 through 2014, reviewed Office of Management and Budget (OMB) guidance on sequestration, reviewed revenue estimates from the Department of Treasury's Green Book, and interviewed IRS officials in the offices of the Chief Financial Officer and Corporate Budget. We interviewed IRS officials and determined that the data presented in this briefing were sufficiently reliable for our purposes.

We conducted this performance audit from April to May 2013 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.

RESULTS IN BRIEF

In summary:

—The fiscal year 2013 annualized continuing resolution rate shown in the fiscal year 2014 budget ($11.9 billion) is not the enacted funding level, and the actual amount is $689 million lower.
—For fiscal year 2014, the President's budget requests an increase for IRS of 9 percent ($1,044 million) in discretionary funding over the fiscal year 2012 appropriation and an increase of 8 percent (6,732 full-time equivalents (FTEs)) in staffing over fiscal year 2012 actual levels. In addition, the funding request includes:
  —Twelve new program initiatives related to enforcement activities and six new program initiatives related to taxpayer service, infrastructure, or other activities.
  —New information on actual return on investment for enforcement activities, and expanded information on information technology (IT) investments, such as lifecycle costs, projected useful life of the current asset, and anticipated benefits.
—The request includes 33 legislative proposals, including 12 related to our prior work.
—As of March 2013, 39 of our products contained 10 matters for congressional consideration and 88 recommendations to IRS with a potential financial benefit that have not been addressed. Since March 2012, IRS has implemented 24 recommendations with a potential financial benefit.

FISCAL YEAR 2013 AND SEQUESTRATION

Funding Levels Down Again, While Demands on Resources Increase With Implementation of Four New Laws

—The fiscal year 2013 annualized continuing resolution rate shown in the fiscal year 2014 budget ($11.9 billion) is not the enacted funding level, and the actual amount is $689 million lower due to sequestration ($594 million), the final continuing resolution adjustment ($71 million), and a 0.2 percent rescission ($24 million).
  —According to IRS budget officials, IRS adjusted its fiscal year 2013 operating plans to reflect these reductions, which are described in the operating plan for fiscal year 2013, released on April 30, 2013.
  —As a result, comparisons in the congressional justification are based on fiscal year 2012 instead of fiscal year 2013.
—The fiscal year 2013 decrease follows a fiscal year 2012 cut of $305 million.
—IRS has been implementing four new laws, relating to (1) the Patient Protection and Affordable Care Act (PPACA),[1] (2) merchant card transaction,[2] (3) basis reporting,[3] and (4) the Foreign Account Tax Compliance Act (FATCA),[4] which have resulted in additional demands for its existing resources.

Sequestration Reduces Fiscal Year 2013 Budget Levels for IRS

According to the Acting IRS Commissioner, as a result of sequestration, IRS may plan to:

—continue to operate under a hiring freeze;
—reduce funding for grants and other expenditures;
—cut costs in areas such as travel, training, facilities, and supplies;
—review contract spending to ensure only the most critical and mandatory requirements are fully funded; and
—furlough all staff for a total of 5 to 7 days after the filing season ends.[5]

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[1] PPACA, Public Law No. 111–148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act (HCERA), Public Law No. 111–152, 124 Stat. 1029 (Mar. 30, 2010). All references to PPACA include amendments by HCERA.

[2] Housing Assistance Tax Act of 2008, Public Law No. 110–289, div. C, § 3091, 122 Stat. 2654, 2908–2911 (July 30, 2008).

[3] Energy Improvement and Extension Act of 2008, Public Law No. 110–343, div. B, § 403, 122 Stat. 3765, 3854–3860 (Oct. 3, 2008).

[4] Hiring Incentives To Restore Employment Act, Public Law 111–147, title V, 124 Stat. 71, 97–117 (Mar. 18, 2010).

[5] The Acting IRS Commissioner announced 5 furlough days, including May 24, 2013, June 14, 2013, July 5, 2013, July 22, 2013, and August 30, 2013, and that two other furlough days may be scheduled in August and September 2013.

TABLE 1.—IRS FUNDING SUBJECT TO SEQUESTRATION AND SUBSEQUENT REDUCTIONS TO DISCRETIONARY IRS APPROPRIATION ACCOUNTS FOR FISCAL YEAR 2013 [a]

Discretionary appropriation accounts	Total sequestrable budget authority amount (in millions)	Sequester percentage	Total sequester amount (in millions)
Enforcement	$5,348	5	$267
Operations support	3,983	5	199
Taxpayer services	2,271	5	113
Business Systems Modernization (BSM)	332	5	17
Total discretionary	[b] 11,934	....	594

Source: GAO analysis of OMB and IRS data.
Note: Numbers may not add due to rounding.
[a] Discretionary appropriations are budgetary resources that are provided in appropriations acts, and do not fund mandatory programs. Sequestration also requires reductions of 5.1 percent to other nonexempt nondefense mandatory programs. IRS has eight appropriation accounts, such as the IRS Miscellaneous Retained Fees account, that fall into this category. The total sequester amount for those appropriation accounts is $232 million.
[b] This amount includes reimbursables ($46 million) and the final continuing resolution adjustment ($71 million).

Cost Saving Actions Taken in Fiscal Year 2012 Resulted in a Lower Base Budget for Fiscal Year 2013

—IRS realized $426 million in savings in fiscal year 2012.
  —Savings and efficiencies resulted from, for example:
    —Reducing FTEs by 3.4 percent ($206 million) through targeted buyouts, attrition, and hiring freezes;
    —transferring lock box fees to taxpayers as part of their installment agreements; [6]
    —reducing IT infrastructure costs (e.g., renegotiating contracts);
    —reducing printing and postage (e.g., stopped weekly mailings of Publication 15, *Employer's Tax Guide*); and
    —reducing travel and training.
—The savings were $236 million more than IRS projected for fiscal year 2012.
—According to IRS budget officials, some savings from fiscal year 2012 are being used in fiscal year 2013 to cover implementation of legislative mandates and sequestration.

FISCAL YEAR 2014 BUDGET DATA AND TRENDS

Summary of Key Budget and FTE Data

—The fiscal year 2014 budget request for IRS is $12.9 billion and 96,218 FTEs.
  —The budget shows a:
    —9 percent increase ($1,044 million) over the fiscal year 2012 appropriation.
    —8 percent increase (6,732 FTEs) in staffing over fiscal year 2012 actual levels.
  —In fiscal year 2014, IRS expects to gain base budget savings and efficiencies of $217 million from cost reduction strategies, such as hiring restrictions, space consolidations, and savings resulting from more electronically filed tax returns.[7]
  —The requested increases include:
    —Twelve new enforcement initiatives, such as a request for $101 million to improve identification and prevention of refund fraud and identity theft.
    —Six taxpayer service, infrastructure, and other initiatives, such as $306 million to implement IT changes to deliver tax credits and other requirements for PPACA.

[6] A lockbox is a post office box established by a financial institution to receive payments made to the IRS.
[7] The savings and efficiencies of $217 million include a net reinvestment of $37.5 million.

Dollars by Appropriation Account, Fiscal Years 2010 Through 2014

TABLE 2.—IRS FISCAL YEARS 2010 THROUGH 2014 BUDGET BY APPROPRIATION ACCOUNT

[Dollars in millions]

Appropriation account	Fiscal year 2010 enacted	Fiscal year 2011 enacted	Fiscal year 2012 enacted	Fiscal year 2013 annualized continuing resolution [a]	Fiscal year 2014 requested	Dollar change fiscal year 2012 enacted compared to fiscal year 2014 requested	Percent change fiscal year 2012 enacted compared to fiscal year 2014 requested
Enforcement	$5,504	$5,493	$5,299	$5,331	$5,667	$367	7
Operations support	4,084	4,057	3,947	3,971	4,481	533	14
Taxpayer services	2,279	2,293	2,240	2,254	2,413	173	8
BSM	264	263	330	332	301	−29	−9
Health Insurance Tax Credit Administration (HITCA) [b]	16	15	(b)	(b)	(b)	n/a	n/a
Subtotal	12,146	12,122	11,817	11,888	12,861	1,044	9
Other resources, such as user fees	539	655	695	905	497	−198	−29
Total funding available for obligation	12,686	12,777	12,512	12,793	13,358	846	7

Legend: n/a = not applicable.

Source: Fiscal year 2012, 2013, and 2014 congressional budget justifications for IRS.

Note: Dollars are nominal and not adjusted for inflation, and numbers may not add due to rounding.

[a] A full-year 2013 appropriation for this account was not enacted at the time the budget was prepared; therefore, the budget assumes this account is operating under the Continuing Appropriations Resolution, 2013 (Public Law 112–175). The amounts included for 2013 reflect the annualized level provided by the continuing resolution and do not include reductions due to sequestration.

[b] In fiscal year 2012, administrative resources for HITCA were moved to the taxpayer services appropriation under the Consolidated Appropriations Act, 2012 (Public Law 112–74).

Staffing by Appropriation Account, Fiscal Years 2010 Through 2014

TABLE 3.—FISCAL YEARS 2010 THROUGH 2014 FULL-TIME EQUIVALENTS BY APPROPRIATION ACCOUNT

Appropriation account	Fiscal year 2010 actual	Fiscal year 2011 actual	Fiscal year 2012 actual	Fiscal year 2013 annualized continuing resolution [a]	Fiscal year 2014 requested	FTE change fiscal year 2012 actual compared to fiscal year 2014 requested	Percent change fiscal year 2012 actual compared to fiscal year 2014 requested
Enforcement	50,400	49,920	47,189	46,702	49,987	2,798	6
Operations support	12,262	12,103	11,499	12,240	13,143	1,644	14
Taxpayer services	31,607	31,574	30,236	30,402	32,575	2,339	8
BSM	337	309	562	513	513	−49	−9
HITCA [b]	12	....	....	....	....	n/a	n/a
Subtotal	94,618	93,906	89,486	89,857	96,218	6,732	8
Other resources, such as user fees	752	1,003	2,185	1,698	1,093	−1,092	−50
Total FTEs	95,370	94,909	91,671	91,555	97,311	5,640	6

Legend: n/a = not applicable.

Source: Fiscal year 2012, 2013 and 2014 congressional budget justifications for IRS.

[a] A full-year 2013 appropriation for this account was not enacted at the time the budget was prepared; therefore, the budget assumes this account is operating under the Continuing Appropriations Resolution, 2013 (Public Law 112–175). The amounts included for 2013 reflect the annualized level provided by the continuing resolution and do not include reductions due to sequestration.

[b] In fiscal year 2012, administrative resources for HITCA were moved to the taxpayer services appropriation under the Consolidated Appropriations Act, 2012 (Public Law 112–74).

Unobligated Balances by Appropriation Account, Fiscal Years 2010 Through 2014

—Funds showed an expected decline in unobligated balances from fiscal years 2012 to 2014.

—IRS's unobligated balances are primarily resulting from no-year, multi-year, and carryover funding and transfers from IRS's Miscellaneous Retained Fee Fund (e.g., user fees) to its discretionary appropriation accounts.

—Fiscal years 2013 and 2014 unobligated balances represent estimates of multi-year and user fee balances for future years.

TABLE 4.—FISCAL YEARS 2010 TO 2014 UNOBLIGATED BALANCES FOR IRS APPROPRIATION ACCOUNTS

[Dollars in millions]

Appropriation account	Fiscal year 2010	Fiscal year 2011	Fiscal year 2012	Fiscal year 2013 estimated	Fiscal year 2014 estimated
Enforcement	$11	$16	$30	$43	$18
Operations support	97	142	178	291	22
Taxpayer services	150	148	192	205	158
BSM	119	179	119	97	104
Total	377	485	519	636	302

Source: GAO analysis of IRS data.

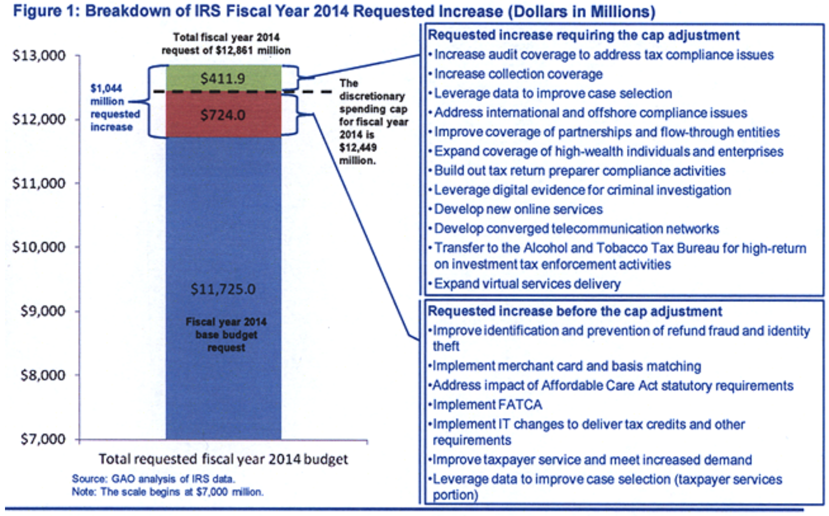
$217 Million in Net Savings and Efficiencies Projected for Fiscal Year 2014

—The fiscal year 2014 budget request for IRS continues efforts to seek savings through:
- —Agency-wide strategies:
  - —Hiring restrictions (e.g., not replacing attrited staff) ($78 million);
  - —Reducing IT infrastructure ($58 million);
  - —Reducing costs and streamlining operations in the human capital function ($8 million);
  - —Consolidating and closing offices ($39 million (net)):
    - —Space optimization (e.g., close, consolidate, or reduce 123 of 648 offices) ($77 million);
    - —One-time reinvestment to implement space optimization, which requires building and consolidating space and relocating employees ($38 million);
- —Program strategies:
  - —Savings related to increases in electronically filed returns ($5 million); and
  - —Reduction in funding to BSM ($30 million).

The Administration Requested a Program Integrity Cap Adjustment of $412 Million for IRS

Congress passes program integrity cap adjustments to allow additional funding above discretionary spending limits for certain activities that are expected to generate benefits that exceed cost.

Figure 1: Breakdown of IRS Fiscal Year 2014 Requested Increase (Dollars in Millions)



NEW INITIATIVES AND RETURN ON INVESTMENT

IRS Proposed 12 Enforcement Initiatives, Totaling $605 Million

TABLE 5.—FUNDING REQUESTED FOR ENFORCEMENT INITIATIVES

[Dollars in millions]

Description of budget adjustments	Fiscal year 2014 funding requested, by appropriation account				Total [a]	Projected ROI for fiscal year 2016 [b]
	Taxpayer services account	Enforcement account	Operations support account	BSM account		
New enforcement initiatives	$38	$365	$202	....	$605	n/a
Increase audit coverage to address tax compliance issues [e]	....	71	39	....	111	3.2
Improve identification and prevention of refund fraud and identity theft	19	48	33	....	101	14.4
Increase collection coverage [e]	....	36	24	....	60	9.3
Leverage data to improve case selection [c, e]	10	4	37	....	52	1.5
Implement merchant card and basis matching	8	30	12	....	50	8.5
Address international and offshore compliance issues [e]	....	43	6	....	49	4.5
Improve coverage of partnerships and flow-through entities [e]	....	39	6	....	45	7.7
Address impact of Patient Protection and Affordable Care Act statutory requirements	1	26	17	....	44	1.9
Implement Foreign Account Tax Compliance Act	....	20	16	....	35	3.7
Expand coverage of high-wealth individuals and enterprises [e]	....	29	5	....	34	13.4
Build out tax return preparer compliance activities [e]	....	16	2	....	18	(d)
Leverage digital evidence for criminal investigation [e]	....	1	4	....	5	(d)
New nonenforcement initiatives	130	8	392	....	531	n/a
Inflation adjustment and pay raises	22	51	52	1	126	n/a
Savings and efficiencies, net reinvestment	−18	−57	−113	−30	−217	n/a
Total appropriations adjustment	173	367	533	−29	[a] 1,044	n/a

Source: Fiscal year 2014 congressional budget justification for IRS.
Notes: Numbers may not add due to rounding.
n/a = not applicable.
[a] The total does not include the final continuing resolution adjustment of $71 million.
[b] According to IRS, new fiscal year 2014 hires will reach full potential in fiscal year 2016. See appendix II for more information on ROI.
[c] The taxpayer services portion of this initiative ($10 million) would not require a program integrity cap adjustment.
[d] IRS does not have assurance that the Build Out Tax Return Preparer Compliance and Leverage Digital Evidence for Criminal Investigations initiatives will produce direct revenue.
[e] Requested increase would require a program integrity cap adjustment.

IRS Proposed Six Taxpayer Service, Infrastructure, and Other Initiatives, Totaling $531 Million

TABLE 6.—FUNDING REQUESTED FOR TAXPAYER SERVICE, INFRASTRUCTURE, AND OTHER INITIATIVES

[Dollars in millions]

Description of budget adjustments	Fiscal year 2014 funding requested, by appropriation account				Total [a]
	Taxpayer services account	Enforcement account	Operations support account	BSM account	
New enforcement initiatives	$38	$365	$202	....	$605
New nonenforcement initiatives	130	8	392	....	531
Implement IT changes to deliver tax credits and other requirements	....	....	306	....	306
Improve taxpayer service and meet increased demand	130	3	44	....	177
Develop new online services [b]	....	....	24	....	24
Develop converged telecommunication networks [b]	....	....	15	....	15
Transfer to the Alcohol and Tobacco Tax and Trade Bureau for high return-on-investment tax enforcement activities [b]	....	5	....	....	5
Expand virtual services delivery [b]	....	....	4	....	4
Inflation adjustment and pay raises	22	51	52	1	126
Savings and efficiencies, net investment	−18	−57	−113	−30	−217
Total appropriations adjustment	173	367	533	−29	[a] 1,044

Source: Fiscal year 2014 congressional budget justification for IRS.
Notes: Numbers may not add due to rounding.
IRS does not calculate ROI for nonenforcement initiatives.
[a] The total does not include the final continuing resolution adjustment of $71 million.
[b] Requested increase would require a program integrity cap adjustment.

$440 Million and 1,954 FTEs Proposed To Implement PPACA in Fiscal Year 2014

—In fiscal year 2014, PPACA funding is included in three of IRS's new funding initiatives.

TABLE 7.—FISCAL YEAR 2014 PPACA BUDGET REQUEST

[Dollars in millions]

Initiatives	Taxpayer services		Enforcement		Operations support		Total	
	Dollars	FTEs	Dollars	FTEs	Dollars	FTEs	Dollars	FTEs
Improve taxpayer service and meet increased demand (PPACA portion of initiative)	$70	908	$3	32	$16	9	$90	949
Address impact of PPACA statutory requirements	1	8	26	223	17	52	44	283
Implement IT changes to deliver tax credits and other requirements	....	....	....	....	306	722	306	722
Total fiscal year 2014 PPACA budget request	71	916	29	255	339	783	440	1,954

Source: Fiscal year 2014 congressional budget justification for IRS.
Note: Numbers may not add due to rounding.

—In fiscal year 2013, IRS requested $360 million to implement PPACA, but did not receive it.

—In fiscal years 2010 through 2012, IRS received a total of $488 million and 1,272 FTEs to implement PPACA from the Department of Health and Human Services' Health Insurance Reform Implementation Fund (HIRIF).

TABLE 8.—IRS HIRIF FUNDING FOR PPACA, FISCAL YEARS 2010 THROUGH 2012

[Dollars in millions]

	Fiscal year 2010	Fiscal year 2011	Fiscal year 2012	Total
Dollars (in millions)	$21	$168	$299	$488
FTEs	31	577	664	1,272

Source: Fiscal year 2014 congressional budget justification for IRS.
Note: Numbers may not add due to rounding.

IRS Reported Actual Return on Investment Data for Three Enforcement Programs for the First Time

TABLE 9.—ACTUAL ROI FOR MAJOR IRS ENFORCEMENT PROGRAMS

[Dollars in millions]

Enforcement program	Fiscal year 2009			Fiscal year 2010			Fiscal year 2011			Fiscal year 2012		
	Cost	Revenue	ROI	Cost	Revenue	ROI	Cost	Revenue	ROI	Cost	Revenue	ROI
Examination	$3,965	$17,446	4.4	$4,371	$23,563	5.4	$4,333	$18,924	4.4	$4,232	$14,476	3.4
Collection	1,880	26,871	14.3	1,948	29,105	14.9	1,939	31,060	16.0	1,742	30,442	17.5
Automated Underreporter	223	4,569	20.5	262	4,924	18.8	270	5,245	19.4	267	5,269	19.7
IRS total	6,068	48,886	8.1	6,581	57,592	8.8	6,543	55,229	8.4	6,242	50,187	8.0

Source: Fiscal year 2014 congressional budget justification for IRS.
Note: Numbers may not add due to rounding.

—IRS made significant progress by calculating average direct actual ROI for the Examination, Collection, and Automated Underreporter programs, as shown in table 9.

—IRS is not yet able to calculate ROI data that measure the marginal revenue produced by additional spending, such as program initiatives, or that include indirect effects of enforcement on voluntary compliance.

—IRS stated that developing actual ROI at the program initiative (marginal) level is challenging. As we reported in December 2012, developing a methodology and using data to improve the allocation of IRS enforcement resources could result in a significant increase in direct revenue.[8]

FISCAL YEAR 2014 IT INVESTMENTS

$2.6 Billion Requested for IT in Fiscal Year 2014 and IRS Expanded Information on IT Investments

—Of the $2.6 billion requested:
  —$1.5 billion is planned to fund 18 major IT investments.[9] The funding for major IT investments comes from multiple sources:
    —$1.2 billion from the operations support appropriation account;
    —$260 million from the BSM appropriation account;
    —$40 million from operations support user fees; and
    —$12 million from other funding sources.[10]
  —$1.1 billion is planned to fund nonmajor IT investments.

—IRS included expanded information on its IT investments in the fiscal year 2014 budget request, including lifecycle costs, projected useful life of the current asset, anticipated benefits and how performance will be measured.

[8] See GAO, *Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources,* GAO–13–151 (Washington, DC: Dec. 5, 2012).

[9] According to IRS, major investments are defined by Treasury as those that cost $10 million in either the current year or budget year, or $50 million over the 5-year period extending from the prior year through budget year +2. Last year, IRS reported 20 major IT systems. The Current Customer Account Data Engine (Current CADE) and Affordable Care Act (ACA, the IT investment supporting IRS's implementation of the PPACA requirements) are no longer on the list. Current CADE was terminated in December 2011. According to IRS, ACA will now be reported as separate nonmajor investments instead of one major investment.

[10] Other funding sources include, for example, IRS Operations Support Reimbursables.

Major IT Investments' Planned Cost

TABLE 10.—COST INFORMATION FOR IRS'S MAJOR IT INVESTMENTS

[Dollars in millions]

Investment name	Fiscal year 2013 funding type [a]	Fiscal year 2013 to 2014 cost [b]	Lifecycle costs	Projected useful life of the current asset (estimated)
Account Management Services (AMS):				
Enhances customer support by providing applications that enable IRS employees to access, validate, and update individual taxpayer accounts on demand.	O&M	$44	$212	2019
Customer Account Data Engine 2 (CADE 2):				
Provides timely access to authoritative individual taxpayer account information and enhances IRS's ability to address technology, security, financial material weaknesses, and long-term architectural planning and viability.	O&M and DME.	496	1,479	2019
Electronic Fraud Detection System (EFDS):				
Assists in detecting fraud at the time that tax returns are filed in order to eliminate the issuance of fraudulent tax refunds.	O&M	38	150	2015
e-Services (e-SVS):				
Comprises several web-based self-assisted services that are intended to allow authorized individuals to do business with the IRS electronically.	O&M and DME.	24	211	2019
Foreign Account Tax Compliance Act (FATCA):				
Intended to implement provisions of the Foreign Account Tax Compliance Act regarding financial institutions reporting to IRS information about financial accounts held by U.S. taxpayers, or foreign entities in which U.S. taxpayers hold a substantial ownership interest.	DME	32	91	2019
Implement Return Review Program (RRP) (Replaces EFDS):				
Currently under development, is intended to maximize fraud detection at the time that tax returns are filed to eliminate issuance of questionable refunds.	DME	75	169	2019
Individual Master File (IMF):				
Represents the authoritative data source for individual tax account data. All other IRS information systems that process IMF data depend on output from this source. This investment is a critical component of IRS's ability to process tax returns.	O&M and DME.	18	108	2019
Information Reporting and Document Matching (IRDM):				
Intended to establish a new business information matching program in order to increase voluntary compliance and accurate income reporting.	O&M and DME.	46	186	2019
Integrated Customer Communication Environment (ICCE):				
Includes several projects that are intended to simplify voluntary compliance using voice response, Internet, and other computer technology such as the Modernized Internet Employee Identification Number, which allows third parties to act on the behalf of taxpayers.	O&M and DME.	33	534	2019

TABLE 10.—COST INFORMATION FOR IRS'S MAJOR IT INVESTMENTS—Continued

[Dollars in millions]

Investment name	Fiscal year 2013 funding type [a]	Fiscal year 2013 to 2014 cost [b]	Lifecycle costs	Projected useful life of the current asset (estimated)
Integrated Data Retrieval System (IDRS):				
Intended to provide systemic review, improve consistency in case control, alleviate staffing needs, issue notices to taxpayers, and allow taxpayers to see status of refunds. It is a mission-critical system used by 60,000 IRS employees.	O&M and DME.	37	322	2019
Integrated Financial System/CORE Financial System (IFS):				
Used by IRS for budget, payroll, accounts payable/receivable, general ledger functions, and financial reporting; also used to report on the cost of operations and to manage budgets by fiscal year.	O&M and DME.	32	483	2019
Integrated Submission and Remittance Processing System (ISRP):				
Processes paper tax returns, and updates tax forms to comply with tax law changes.	O&M and DME.	24	192	2019
IRS End User Systems and Services (EUSS):				
Supports products and services necessary for daily functions for over 100,000 IRS employees at headquarters and field sites.	O&M	381	1,684	2025
IRS Main Frames and Servers Services and Support (MSSS):				
Intended to support the design, development, and deployment of server storage infrastructures, software, databases, and operating systems.	O&M	810	6,016	2025
IRS Telecommunications Systems and Support (TSS):				
Supports IRS's broad and local network infrastructure such as servers, and switches for voice, data, and video servicing of about 1,000 IRS sites.	O&M	594	2,583	2021
IRS.Gov-Portal Environment:				
Provides web-based services such as tax filing and refund tracking, to internal and external users, such as IRS employees and other government agencies, taxpayers, and business partners.	O&M and DME.	131	612	2020
Modernized e-File (MeF):				
Provides a secure web-based platform for electronic tax filing of individual and business tax and information returns by registered Electronic Return Originators.	O&M and DME.	140	575	2019
Service Center Recognition/Image Processing System (SCRIPS):				
Used as a data capture, management, and image storage system using high-speed scanning and digital imaging to convert data from the 940, 941, K–1, and paper returns from Information Returns Processing into electronic format.	O&M and DME.	19	195	2019

Source: GAO analysis of fiscal year 2014 congressional budget justification for IRS.

[a] O&M = Operations and Maintenance; DME = Development/Modernization/Enhancement.

[b] The fiscal year 2013 to 2014 cost is defined as the base fiscal year 2013 budget plus the fiscal year 2014 request.

LEGISLATIVE PROPOSALS

GAO Conducted Analyses Related to 12 of the 33 Legislative Proposals in the Fiscal Year 2014 Budget

TABLE 11.—LEGISLATIVE PROPOSALS RELATED TO PRIOR GAO WORK

[In millions]

IRS legislative proposals related to prior GAO work	Projected revenues over 10 years	Projected costs over 3 years	Related GAO reports
Modify reporting of tuition expenses and scholarships on Form 1098–T, Tuition Statement.	$1,095	Not available	GAO–10–225, GAO–13–279SP
Increase certainty about the rules pertaining to classification of employees as independent contractors.	9,097	$1.9	GAO–09–717
Extend IRS math error authority in certain circumstances.	185	1.4	GAO–10–349, GAO–10–225, GAO–11–481
Allow IRS to absorb credit and debit card processing fees for certain tax payments.	19	9.6	GAO–10–11
Provide Treasury with the regulatory authority to require additional information to be included in electronically filed Form 5500, Annual Return/Report of Employee Benefit Plan, and electronic filing of certain other employee benefit plan reports.	No revenue effect	11.2	GAO–05–491
Require taxpayers who prepare their returns electronically, but file their returns on paper, to print their returns with a two-dimensional bar code.	No revenue effect	6.8	GAO–12–33, GAO–08–38
Require all Form 990 series tax and information returns be filed electronically and provide IRS with regulatory authority to make the electronically filed Form 990 series returns publicly available in a machine readable format in a timely manner.	No revenue effect	Not available	GAO–02–526, GAO–02–444, GAO–06–799
Restrict access to Death Master File	1,303	Not available	GAO–02–233T
Provide whistleblowers with protection from retaliation.	Negligible revenue effect	Not available	GAO–11–683
Provide stronger protection from improper disclosure of taxpayer information in whistleblower actions.	No revenue effect	Not available	GAO–11–683
Add tax crimes to the Aggravated Identity Theft Statute.	Negligible revenue effect	Not available	GAO–13–132T, GAO–09–882, GAO–02–766
Impose a civil penalty on tax identity theft crimes.	Negligible revenue effect	Not available	GAO–13–132T, GAO–09–882, GAO–02–766

Source: IRS, Fiscal year 2014 congressional budget justification, and Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals* (Washington, DC: April 2013).

OPEN MATTERS AND RECOMMENDATIONS

Implementing Open Matters for Congress and Recommendations to IRS Could Result in Financial Benefits

—We highlighted several areas where IRS could achieve cost savings and revenue enhancements in our duplication, overlap, and fragmentation reports.[11]

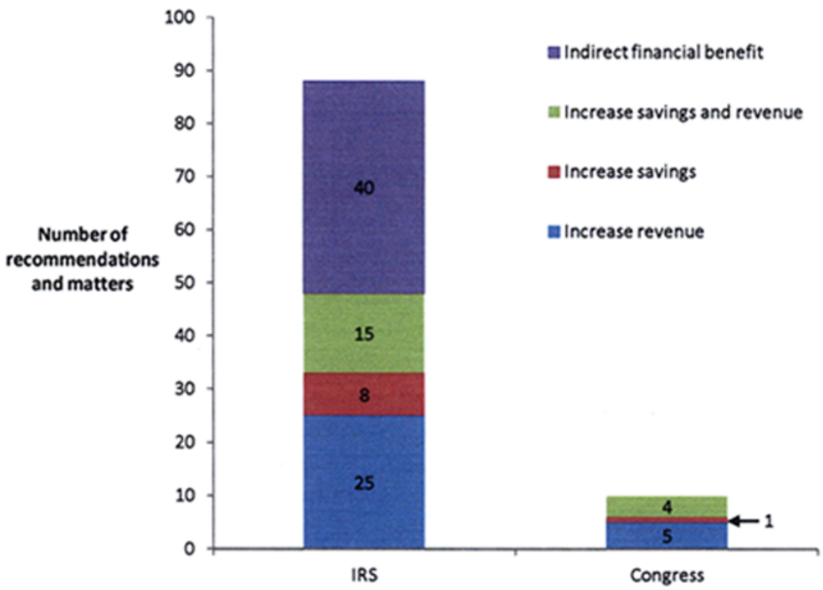
—As of March 2013, 39 of our products contain 10 matters for congressional consideration and 88 recommendations to IRS with a potential financial benefit that have not been addressed. In addition, we have multiple other recommenda-

[11] See GAO, *2013 Annual Report: Actions Needed To Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits,* GAO–13–279SP (Washington, DC: Apr. 9, 2013), *2012 Annual Report: Opportunities To Reduce Duplication, Overlap and Fragmentation, Achieve Savings, and Enhance Revenue,* GAO–12–342SP (Washington, DC: Feb. 28, 2012), and *Opportunities To Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue,* GAO–11–318SP (Washington, DC: Mar. 1, 2011).

tions that could improve IRS operations if implemented. See appendix III for a list of products.

—Since March 2012, IRS has implemented 24 recommendations with a potential financial benefit.

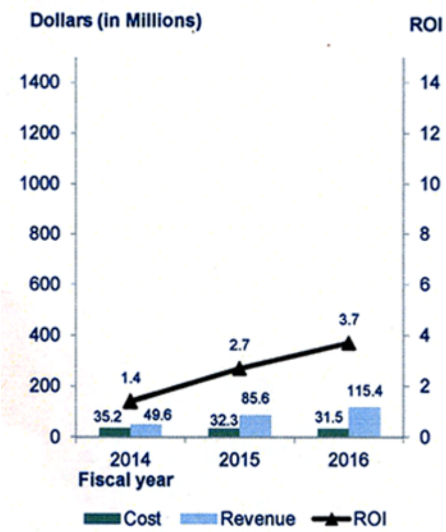
Figure 2: Recommendations to IRS and Open Matters for Congress with a Financial Benefit



APPENDIX II: RETURN ON INVESTMENT CHARTS

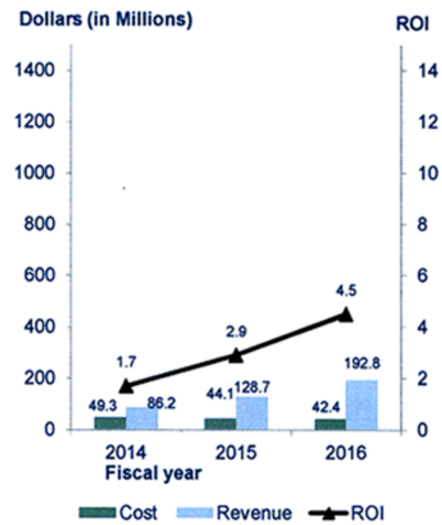
IRS ESTIMATED FUTURE ROI FOR 10 OF THE 12 NEW ENFORCEMENT INITIATIVES

Figure 3: Implement FATCA



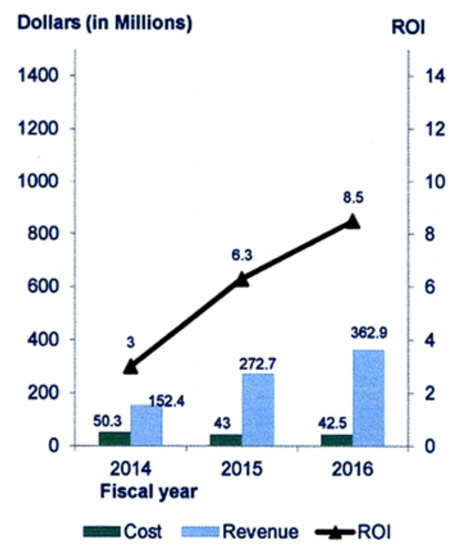
Source: GAO analysis of IRS data.

Figure 4: Address International and Offshore Compliance Issues



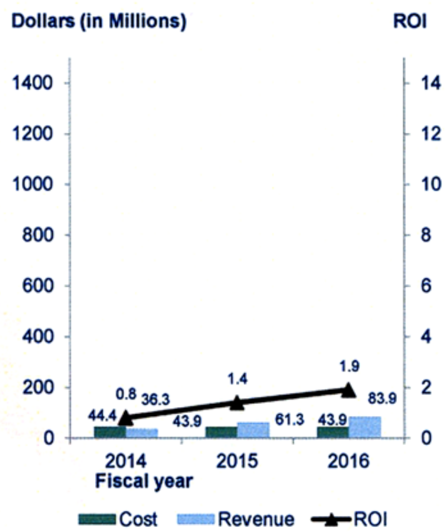
Source: GAO analysis of IRS data.

Figure 5: Implement Merchant Card and Basis Matching



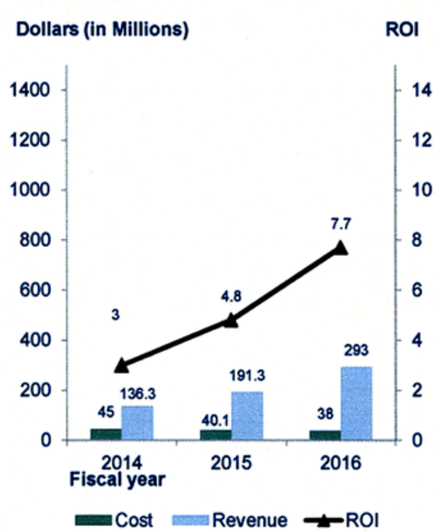
Source: GAO analysis of IRS data.

Figure 6: Address Impact of PPACA Statutory Requirements



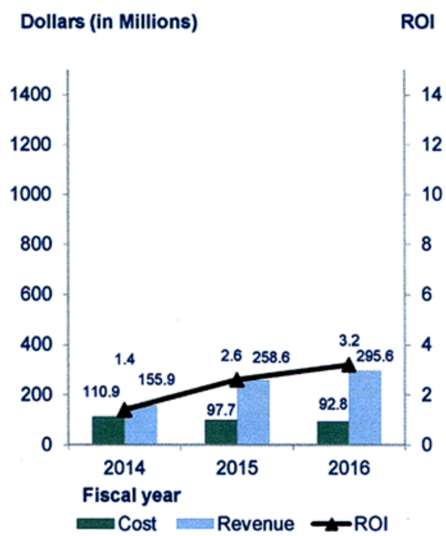
Source: GAO analysis of IRS data.

Figure 7: Improve Coverage of Partnerships and Flow-Through Entities



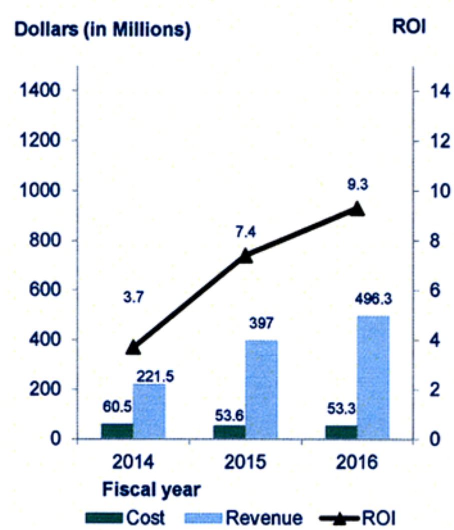
Source: GAO analysis of IRS data.

Figure 8: Increase Audit Coverage to Address Tax Compliance Issues



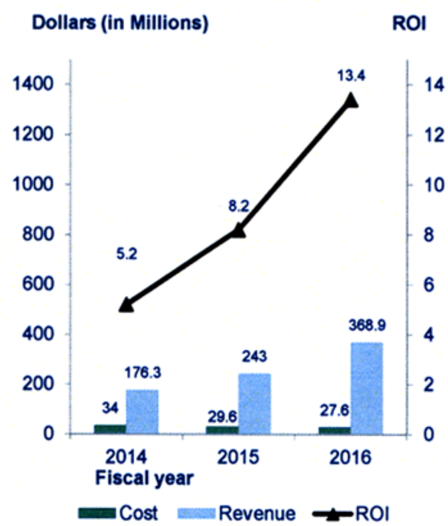
Source: GAO analysis of IRS data.

Figure 9: Increase Collection Coverage



Source: GAO analysis of IRS data.

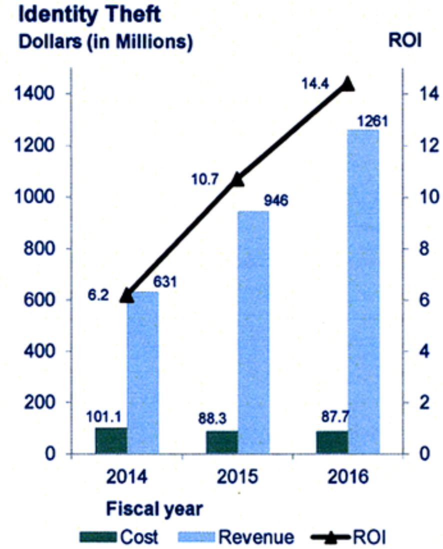
Figure 10: Expand Coverage of High-Wealth Individuals and Enterprises



Source: GAO analysis of IRS data.

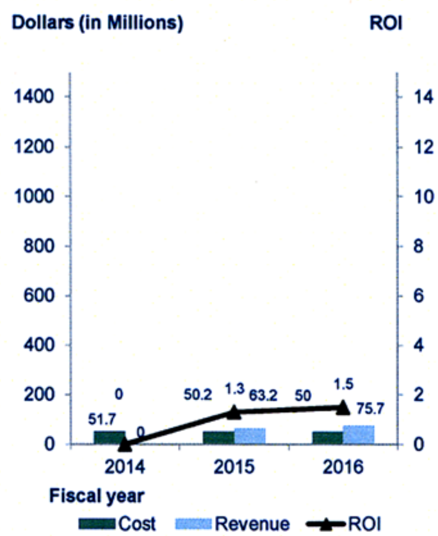
Note: Figures 11 and 12 do not use IRS's traditional ROI calculation. Figure 11 shows an initiative to protect revenue and Figure 12 shows an initiative to entrance revenue.

Figure 11: Improve Identification and Prevention of Refund Fraud and Identity Theft



Source: GAO analysis of IRS data.

Figure 12: Leverage Data to Improve Case Selection



Source: GAO analysis of IRS data.

Appendix III: GAO Products With Open Matters for Congressional Consideration and Recommendations to IRS With a Potential Financial Benefit

Thirty-nine GAO products contain 10 matters for congressional consideration and 88 recommendations to IRS with a potential financial benefit that have not been addressed. Thirty have the potential to increase revenue (IR), 9 increase savings (IS), 19 increase both savings and revenue (ISR), and 40 may have indirect financial benefits (IFB).

TABLE 12.—LIST OF OPEN MATTERS FOR CONGRESS AND RECOMMENDATIONS TO IRS THAT COULD RESULT IN POTENTIAL SAVINGS OR INCREASED REVENUES OR BOTH

Report title and number	Web site for current status of matters and/or recommendations	Potential financial benefits
Addressing identity theft:		
Identify Theft: Total Extent of Refund Fraud Using Stolen Identities Is Unknown (GAO–13–132T).	http://www.gao.gov/products/GAO–13–132T	IFB
Detecting abusive tax avoidance transactions:		
Abusive Tax Avoidance Transactions: IRS Needs Better Data To Inform Decisions about Transactions (GAO–11–493).	http://www.gao.gov/products/GAO–11–493	IR, IFB
Enhancing budget requests:		
IRS 2013 Budget: Continuing To Improve Information on Program Costs and Results Could Aid in Resource Decision Making (GAO–12–603).	http://www.gao.gov/products/GAO–12–603	IS, IFB
IRS Budget 2012: Extending Systematic Reviews of Spending Could Identify More Savings Over Time (GAO–11–547).	http://www.gao.gov/products/GAO–11–547	IS
Enhancing collection of user fees:		
User Fees: Additional Guidance and Documentation Could Further Strengthen IRS's Biennial Review of Fees (GAO–12–193).	http://www.gao.gov/products/GAO–12–193	IFB
Enhancing electronic filing:		
E-Filing Tax Returns: Penalty Authority and Digitizing More Paper Return Data Could Increase Benefits (GAO–12–33).	http://www.gao.gov/products/GAO–12–33	IS, ISR, IFB
Electronic Tax Return Filing: Improvements Can Be Made Before Mandate Becomes Fully Implemented (GAO–11–344).	http://www.gao.gov/products/GAO–11–344	IS
Tax Administration: Opportunities Exist for IRS To Enhance Taxpayer Service and Enforcement for the 2010 Filing Season (GAO–09–1026).	http://www.gao.gov/products/GAO–09–1026	ISR
Enhancing electronic filing and improving accuracy of paid preparers:		
Tax Administration: Many Taxpayers Rely on Tax Software and IRS Needs To Assess Associated Risks (GAO–09–297).	http://www.gao.gov/products/GAO–09–297	IFB
Enhancing internal controls:		
Management Report: Improvements Are Needed To Enhance the Internal Revenue Service's Internal Controls and Operating Effectiveness (GAO–11–494R).	http://www.gao.gov/products/GAO–11–494R	IS, IFB
Enhancing taxpayer services:		
2012 Tax Filing: IRS Faces Challenges Providing Service to Taxpayers and Could Collect Balances Due More Effectively (GAO–13–156).	http://www.gao.gov/products/GAO–13–156	ISR
2011 Tax Filing: Processing Gains, but Taxpayer Assistance Could Be Enhanced by More Self-Service Tools (GAO–12–176).	http://www.gao.gov/products/GAO–12–176	ISR
Enhancing treatment of appraisals issues:		
Appraised Values on Tax Returns: Burdens on Taxpayers Could Be Reduced and Selected Practices Improved (GAO–12–608).	http://www.gao.gov/products/GAO–12–608	ISR
Expanding use of math error authority or third party data:		
2011 Tax Filing: IRS Dealt With Challenges to Date but Needs Additional Authority To Verify Compliance (GAO–11–481).	http://www.gao.gov/products/GAO–11–481	IR
Recovery Act: IRS Quickly Implemented Tax Provisions, but Reporting and Enforcement Improvements Are Needed (GAO–10–349).	http://www.gao.gov/products/GAO–10–349	ISR
2009 Tax Filing Season: IRS Met Many 2009 Goals, but Telephone Access Remained Low, and Taxpayer Service and Enforcement Could Be Improved (GAO–10–225).	http://www.gao.gov/products/GAO–10–225	IR, ISR

TABLE 12.—LIST OF OPEN MATTERS FOR CONGRESS AND RECOMMENDATIONS TO IRS THAT COULD RESULT IN POTENTIAL SAVINGS OR INCREASED REVENUES OR BOTH—Continued

Report title and number	Web site for current status of matters and/or recommendations	Potential financial benefits
Tax Administration: IRS's 2008 Filing Season Generally Successful Despite Challenges, Although IRS Could Expand Enforcement During Returns Processing (GAO–09–146).	http://www.gao.gov/products/ GAO–09–146	ISR
Implementing Information Reporting and Document Matching (IRDM) system:		
IRS Management: Cost Estimate for New Information Reporting System Needs To Be Made More Reliable (GAO–12–59).	http://www.gao.gov/products/ GAO–12–59	IFB
Information Reporting: IRS Could Improve Cost Basis and Transaction Settlement Reporting Implementation (GAO–11–557).	http://www.gao.gov/products/ GAO–11–557	IFB
Implementing Patient Protection and Affordable Care Act (PPACA):		
Patient Protection and Affordable Care Act: IRS Managing Implementation Risks, but Its Approach Could Be Refined (GAO–12–690).	http://www.gao.gov/products/ GAO–12–690	IFB
Patient Protection and Affordable Care Act: IRS Should Expand Its Strategic Approach to Implementation (GAO–11–719).	http://www.gao.gov/products/ GAO–11–719	IFB
Improving allocation of enforcement resources:		
Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources (GAO–13–151).	http://www.gao.gov/products/ GAO–13–151	IR
Improving collection of unpaid taxes from Medicaid providers:		
Medicaid: Providers in Three States With Unpaid Federal Taxes Received Over $6 Billion in Medicaid Reimbursements (GAO–12–857).	http://www.gao.gov/products/ GAO–12–857	IS
Improving corporate tax compliance:		
Tax Gap: Actions Needed to Address Noncompliance with S Corporation Tax Rules (GAO–10–195).	http://www.gao.gov/products/ GAO–10–195	IR, IFB
Improving individual or corporate tax compliance:		
Financial Derivatives: Disparate Tax Treatment and Information Gaps Create Uncertainty and Potential Abuse (GAO–11–750).	http://www.gao.gov/products/ GAO–11–750	IFB
Federal Tax Collection: Potential for Using Passport Issuance To Increase Collection of Unpaid Taxes (GAO–11–272).	http://www.gao.gov/products/ GAO–11–272	IR
Improving management of information technology (IT) investments:		
Investment Management: IRS Has a Strong Oversight Process but Needs To Improve How It Continues Funding Ongoing Investments (GAO–11–587).	http://www.gao.gov/products/ GAO–11–587	IS, IFB
Improving offshore compliance:		
Offshore Tax Evasion: IRS Has Collected Billions of Dollars, but May Be Missing Continued Evasion (GAO–13–318) [a].	http://www.gao.gov/products/ GAO–13–318	IR
Improving real estate tax compliance:		
Tax Administration: Expanded Information Reporting Could Help IRS Address Compliance Challenges With Forgiven Mortgage Debt (GAO–10–997).	http://www.gao.gov/products/ GAO–10–997	IR
Home Mortgage Interest Deduction: Despite Challenges Presented by Complex Tax Rules, IRS Could Enhance Enforcement and Guidance (GAO–09–769).	http://www.gao.gov/products/ GAO–09–769	IR
Real Estate Tax Deduction: Taxpayers Face Challenges in Determining What Qualifies; Better Information Could Improve Compliance (GAO–09–521).	http://www.gao.gov/products/ GAO–09–521	IR
Improving rental real estate compliance:		
Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance (GAO–08–956).	http://www.gao.gov/products/ GAO–08–956	IR
Improving sole proprietors' compliance:		
Tax Gap: Limiting Sole Proprietor Loss Deductions Could Improve Compliance but Would Also Limit Some Legitimate Losses (GAO–09–815).	http://www.gao.gov/products/ GAO–09–815	IFB
Improving tax credit administration:		
Small Employer Health Tax Credit: Factors Contributing to Low Use and Complexity (GAO–12–549).	http://www.gao.gov/products/ GAO–12–549	ISR

TABLE 12.—LIST OF OPEN MATTERS FOR CONGRESS AND RECOMMENDATIONS TO IRS THAT COULD RESULT IN POTENTIAL SAVINGS OR INCREASED REVENUES OR BOTH—Continued

Report title and number	Web site for current status of matters and/or recommendations	Potential financial benefits
Improving third party compliance:		
Tax Gap: IRS Could Do More To Promote Compliance by Third Parties With Miscellaneous Income Reporting Requirements (GAO–09–238).	http://www.gao.gov/products/GAO–09–238	IR, IFB
Improving use of whistleblower claims:		
Tax Whistleblowers: Incomplete Data Hinders IRS's Ability To Manage Claim Processing Time and Enhance External Communication (GAO–11–683).	http://www.gao.gov/products/GAO–11–683	IR, IFB
Increasing tax debt collection:		
Tax Debt Collection: IRS Needs To Better Manage the Collection Notices Sent to Individuals (GAO–09–976).	http://www.gao.gov/products/GAO–09–976	ISR
Promoting effective use of third-party data:		
Tax Gap: IRS Has Modernized Its Business Nonfiler Program but Could Benefit From More Evaluation and Use of Third-Party Data (GAO–10–950).	http://www.gao.gov/products/GAO–10–950	IR, IFB
Reducing tax evasion:		
Tax Gap: IRS Can Improve Efforts To Address Tax Evasion by Networks of Businesses and Related Entities (GAO–10–968).	http://www.gao.gov/products/GAO–10–968	IFB

Legend: IR—Increase revenue, IS—Increase savings, ISR—Increase savings and revenue, IFB—Indirect financial benefit.
Source: GAO.
Notes: Products with open matters and recommendations identified as of March 11, 2013, with the exception of GAO–13–318 (see table note a). Some products may have matters and/or recommendations that do not have potential financial benefits or could be placed in different categories than provided above.
[a] This product includes open recommendations identified as of March 27, 2013.

APPENDIX IV: GAO CONTACT AND STAFF ACKNOWLEDGEMENTS

GAO CONTACT

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STAFF ACKNOWLEDGEMENTS

In addition to the contact named above, Libby Mixon, Assistant Director; Amy Bowser, Chuck Fox, Paul Middleton, Ulyana Panchishin, Sabine Paul, Laurel Plume, Neil Pinney, Mark Ryan, Erinn L. Sauer, Cynthia Saunders, and Robert Yetvin made key contributions to this report.

PREPARED STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE

Chairman Lautenberg, Ranking Member Johanns, and distinguished members of this subcommittee:

Thank you for inviting me to submit this statement regarding the proposed budget of the Internal Revenue Service for fiscal year 2014.[1]

I have been privileged to serve as the National Taxpayer Advocate since 2001, and I have never been more concerned than I am today about the IRS's ability to fulfill its mission of helping taxpayers voluntarily comply with their tax obligations and collecting the revenue on which the rest of the government depends.[2]

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

[2] In the National Taxpayer Advocate's 2011 and 2012 Annual Reports to Congress, I identified the significant and chronic underfunding of the IRS as one of the most serious problems facing taxpayers. *See* National Taxpayer Advocate 2012 Annual Report to Congress 34–41 (Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*); National Taxpayer Advocate 2011 Annual Report to Congress 3–27 (Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*).

Since fiscal year 2010, the IRS's budget has been reduced by nearly $1 billion, or about 8 percent, due to across-the-board budget cuts and sequestration.[3] Consequently, the IRS is unable to answer about one out of every three calls it receives from taxpayers seeking to speak with an employee.[4] It is unable to process a high percentage of taxpayer letters responding to IRS compliance notices within established timeframes.[5] It is unable to assist hundreds of thousands of identity theft victims in a timely manner, instead requiring them to wait 6 months or longer to receive their refunds.[6] It continues to automate enforcement tasks, making it harder for taxpayers who need to speak with an employee to do so.[7] And by the end of fiscal year 2013, it projects it will have cut its training budget by more than 80 percent, which in my view is leaving employees less able to assist taxpayers properly.[8]

On April 15, the statutory deadline for filing individual income tax returns, the IRS managed to answer only 57 percent of the calls it received.[9] By any measure, 57 percent is an "F." At the risk of understatement, the taxpaying public deserves better.

THE IRS BUDGET SHOULD BE FENCED OFF FROM ACROSS-THE-BOARD BUDGET CUTS AND SEQUESTRATION BECAUSE A CRIPPLED IRS MEANS INADEQUATE TAXPAYER SERVICE, LESS REVENUE COLLECTION, AND ULTIMATELY A LARGER BUDGET DEFICIT

The rationale for cutting Federal spending generally is to help reduce the imbalance between spending and revenue. Yet the IRS is different from all other Federal agencies: It is the revenue collector. Each dollar appropriated for the IRS generates substantially more than $1 dollar in Federal revenue. In fiscal year 2012, the IRS collected about $2.52 trillion[10] on a budget of about $11.8 billion.[11] That translates to an average return-on-investment (ROI) of about 214:1. The marginal ROI of additional spending will not be nearly so large, but virtually everyone who has studied the IRS budget has concluded that the ROI of additional funding is positive. In 2011, former Commissioner Shulman estimated in a letter to Congress that proposed cuts to the IRS budget would result in reduced revenue collection of seven times as much as the cuts.[12]

If the chief executive officer of a Fortune 500 company were told that each dollar allocated to his company's accounts receivable department would generate $7 dollars

[3] *See* Hearing Before Subcomm. on Financial Services and General Government of H. Comm. on Appropriations, 113th Cong. (2013) (statement of Steven T. Miller, Acting Commissioner of Internal Revenue), at http://appropriations.house.gov/uploadedfiles/hhrg-113-ap23-wstate-millers-20130409.pdf.

[4] IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2012). The Accounts Management phones lines (previously known as the Customer Account Services phone lines) receive the significant majority of taxpayer calls. However, calls to compliance phone lines and certain other categories of calls are excluded from this total.

[5] During the final week of fiscal year 2012, the backlog of correspondence in the tax adjustments inventory stood at over 1 million letters, and the percentage classified as "overage" stood at 48 percent. IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 29, 2012).

[6] *See, e.g.,* National Taxpayer Advocate 2012 Annual Report to Congress 42–67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*).

[7] *See, e.g.,* National Taxpayer Advocate 2011 Annual Report to Congress 93–108 (Most Serious Problem: *Automated "Enforcement Assessments" Gone Wild: IRS Efforts to Address the Non-Filer Population Have Produced Questionable Business Results for the IRS, While Creating Serious Burden for Many Taxpayers*); see also National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, at 63–90 (*An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*), which notes that automation is leading to fewer personal contacts with taxpayers and lack of awareness among taxpayers that they are facing an enforcement action.

[8] IRS Fact Sheet, FS–2013–05, *IRS Achieves $1 Billion in Cost Savings and Efficiencies* (April 2013), at http://www.irs.gov/uac/IRS-Achieves-$1-Billion-in-Cost-Savings-and-Efficiencies (last visited May 1, 2013).

[9] IRS, Joint Operations Center, *Accounts Management Rollup* (Apr. 15, 2013).

[10] Government Accountability Office (GAO), GAO–13–120, *Financial Audit: IRS's Fiscal Years 2012 and 2011 Financial Statements* 65 (Nov. 2012), at http://www.gao.gov/assets/650/649881.pdf.

[11] Department of the Treasury, *Fiscal Year 2013 Budget in Brief, at* http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/11.%20IRS_508%20-%20passed.pdf.

[12] Letter from Douglas H. Shulman, Commissioner of Internal Revenue, to the chairmen and ranking members of the House Committee on Ways and Means (and its Subcommittee on Oversight) and the Senate Committee on Finance (Oct. 17, 2011), *at* http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/media/pdf/112/Rep_Lewis_IRS_Letter.pdf. In addition to generating direct revenue, IRS compliance actions produce indirect revenue gains. Studies show that taxpayers who might otherwise be tempted to bend the rules report their income more accurately as the likelihood of an audit increases.

in return, it is difficult to see how the CEO would keep his job if he chose not to provide the department with the funding it needed. Yet that is exactly what has been happening with respect to IRS funding for years, and there has been little effort to fix this obvious problem.

This is not a new issue. It arises because the Federal budgeting rules generally treat the IRS in the same manner as all other Federal agencies, giving it no "credit" for the revenue it collects. Once this subcommittee receives its section 302(b) allocation for the upcoming fiscal year, funding the programs under your jurisdiction is essentially a zero sum game—each dollar allocated to one agency reduces the pool of funds available for others.[13]

In the National Taxpayer Advocate's 2006 Annual Report to Congress, I discussed the IRS funding challenge in detail and recommended, among other things, that Congress consider revising its budget rules in a manner that allows the relevant congressional committees to consider and decide: "What level of funding will maximize tax compliance, particularly voluntary compliance, with our nation's tax laws, with due regard for protecting taxpayer rights and minimizing taxpayer burden?" I recommended that Congress revise the budget rules so it could then set the IRS funding level accordingly, without regard to spending caps.[14]

In the course of developing and presenting that recommendation, my staff and I met with 14 separate congressional staffs—specifically, the House and Senate majority and minority staffs of the appropriations committees, budget committees, and tax writing committees as well as tax counsel for the House and Senate majority leaders. In our discussions, there appeared to be no significant disagreement with the premise that the IRS generates a positive return on investment and is underfunded. However, we were repeatedly told that creating a new set of rules to establish IRS funding levels would be a "heavy lift" and would raise jurisdictional issues that have to be worked through. The last three IRS Commissioners have also raised these concerns.[15] So have the former chairman and ranking member of the Senate Budget Committee.[16]

I believe the time to attempt the "heavy lift" is now. Not only are cuts to the IRS budget harmful from a taxpayer service perspective, but to the extent they are designed to reduce the budget deficit, they are self-defeating. For the reasons I have described, reductions in the IRS budget almost surely lead to a larger deficit. In fiscal terms, the IRS's mission trumps those of all other agencies, because without an effective revenue collector, those agencies could not exist. If the IRS is not properly funded to collect the revenue, there will be fewer dollars available for the military, for social programs, for intelligence and embassy protection, for infrastructure maintenance, for medical research—or simply for deficit reduction.

Just as a Fortune 500 company would find a way to fund its accounts receivable department, I encourage the members of this subcommittee to work with their colleagues on the full Appropriations Committee, the Budget Committee, and the Finance Committee to exempt the IRS from across-the-board spending cuts and begin to recognize the IRS's unique role as the agency that collects the revenue that makes all other government programs possible.

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[13] *See* Congressional Budget and Impoundment Control Act, Public Law No. 93–344, § 302(b)(1), 88 Stat. 297, 308 (1974) (providing that the Appropriations Committee of each House shall subdivide its allocation of funding under the annual budget resolution among its subcommittees). The "program integrity cap adjustment" mechanism, which I discuss in the text below, is a limited but flawed exception to this rule.

[14] *See* National Taxpayer Advocate 2006 Annual Report to Congress 442–457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*), *at* http://www.irs.gov/pub/irs-utl/2006_arc_section2_v2.pdf.

[15] *See, e.g.,* Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 278 (2005) ("When I talked to business friends about my job at the IRS, they were always surprised when I said that the most intractable part of the job, by far, was dealing with the IRS budget. The reaction was usually 'Why should that be a problem? If you need a little money to bring in a lot of money, why wouldn't you be able to get it?' ").

[16] In 2006, Senator Judd Gregg acknowledged that the existing budget procedures have the effect of shortchanging the IRS. He said: "We've got to talk to the [Congressional Budget Office] about scoring on [additional funding provided to IRS]. Clearly there's a return on that money." Dustin Stamper, *Everson Pledges to Narrow Growing Tax Gap,* 110 Tax Notes 807 (Feb. 20, 2006). Similarly, Senator Kent Conrad stated: "Rather than a tax increase, I think the first place we ought to look . . . is the tax gap. If we could collect this money, we'd virtually eliminate the deficit." Emily Dagostino, *Senate Budget Resolution Would Increase IRS Enforcement Funding,* 110 Tax Notes 1129 (Mar. 13, 2006).

IF A "PROGRAM INTEGRITY CAP ADJUSTMENT" MECHANISM IS USED, IT SHOULD ENCOMPASS TAXPAYER SERVICE ACTIVITIES AS WELL AS ENFORCEMENT

In a partial attempt to address this problem, several appropriations acts in recent years have given the IRS additional funding by using a mechanism known as a "program integrity cap adjustment." Under this mechanism, new funding appropriated for IRS *enforcement* programs generally does not count against otherwise applicable spending ceilings provided:

—The IRS's existing enforcement base is fully funded; and

—A determination is made that the proposed additional expenditures will generate an ROI of greater than 1:1 (*i.e.,* the additional expenditures will increase Federal revenue on a net basis).

The administration's budget proposal released last month recommends a change to the Balanced Budget and Emergency Deficit Control Act of 1985 to provide program integrity cap adjustments for the next 10 years.[17] While this cap adjustment mechanism may provide an easier path to providing the IRS with more resources than a fundamental change in IRS funding rules, I am concerned that taxpayer service activities have been excluded from this enhanced funding mechanism in the past and would continue to be excluded under the administration's proposal. The rationale has been that the IRS is able to measure the direct ROI of its enforcement activities—i.e., it can compute to the dollar the amounts collected by its examination, collection, and document matching functions —but is unable to quantify the ROI of taxpayer services. Thus, it is not currently possible to document whether or to what extent its taxpayer services generate an ROI greater than 1:1.

Creating a mechanism that allows more funding for enforcement actions while excluding taxpayer service activities like outreach and education would be a mistake, for two reasons. First, common sense tells us that taxpayer services are a significant driver of tax compliance and generate a very high ROI. Publishing tax forms and instructions, conducting outreach and education, assisting taxpayers, tax preparers, and tax-software manufacturers, and otherwise administering the tax filing season are absolute prerequisites for tax compliance. In general, the ROI of these service activities is probably greater than the ROI of enforcement actions. As I discussed in detail in the National Taxpayer Advocate's 2012 Annual Report to Congress, the IRS could greatly improve its taxpayer services if it received additional funding for that purpose.

Second, an enforcement-only cap adjustment will inherently push the IRS to become more of a hard core enforcement agency. It should be emphasized that in fiscal year 2012, direct enforcement revenue amounted to only $50.2 billion,[18] or 2 percent of total IRS tax collection of $2.52 trillion.[19] The remaining 98 percent resulted from voluntary front-end tax compliance. If cap adjustments are applied solely to bolster enforcement funding, the relative allocation of the IRS budget between enforcement and taxpayer service will shift over time in a direction that causes taxpayers to fear the IRS more and voluntarily cooperate less. Primarily because of the proposed cap adjustments, the administration's 10-year funding projections show that funding for the IRS enforcement appropriation would increase by more than twice as much as funding for the IRS's taxpayer services appropriation.[20] In our effort to enforce the laws against noncompliant taxpayers, we must take care to avoid steps that may alienate compliant taxpayers and thereby jeopardize the existing tax base.

If program integrity cap adjustments are used, I recommend that compliance initiatives be defined more broadly, so they include both an enforcement component and a service component (*e.g.,* better outreach, education, and assistance for small businesses). Because the projected ROI of many enforcement programs is high, a more broadly constructed initiative could still produce a demonstrable ROI of great-

[17] *See* Department of the Treasury, General Explanations of the Administration's fiscal year 2014 Revenue Proposals 187 (Apr. 2013).

[18] IRS, fiscal year 2012 Enforcement and Service Results, *at* http://www.irs.gov/pub/irs-news/FY%202012%20enforcement%20and%20service%20results-%20Media.pdf.

[19] GAO, GAO–13–120, *Financial Audit: IRS's Fiscal Years 2012 and 2011 Financial Statements* 65 (Nov. 2012), *at* http://www.gao.gov/assets/650/649881.pdf.

[20] Budget of the United States Government: Analytical Perspectives, Supplemental Materials Fiscal Year 2014: Table 32–1, Federal Programs by Agency and Account, at 304–305, *at* http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/32__1.pdf. Taxpayer service spending is shown on the top line, which is labeled "Taxpayer Services: Appropriations, discretionary . . . 803." Enforcement spending is the sum of the line labeled "Federal law enforcement activities: Appropriations, discretionary . . . 751" and the line labeled "Central fiscal operations: Appropriations, discretionary . . . 803." Over the fiscal year 2014 through fiscal year 2023 period, these projections show that Taxpayer Services spending would rise by 23 percent, while Enforcement spending would increase by 54 percent.

er than 1:1, even if it contained service components with ROIs that are unquantifiable.[21]

A REDUCTION IN THE IRS TRAINING BUDGET OF MORE THAN 80 PERCENT AND OVERLY RIGID TRAINING APPROVAL REQUIREMENTS WILL LEAVE IRS EMPLOYEES ILL EQUIPPED TO DO THEIR JOBS AND MEET TAXPAYER NEEDS

I am deeply concerned about the dramatic reduction in the training budget for IRS employees. Because of budget constraints, the IRS's full-time, permanent workforce was cut from about 86,000 to 79,000 employees from fiscal year 2010 to fiscal year 2012, a decrease of 8 percent.[22] This workforce reduction makes it imperative that the remaining IRS employees receive top quality training so they can perform their jobs as effectively and efficiently as possible. Yet the IRS estimates that by the end of fiscal year 2013, it will have cut its training budget by *83 percent* as compared with fiscal year 2010.[23]

I view this as a very serious problem. In most years, workforce attrition exceeds 5 percent. When employees leave, the IRS must identify existing or new employees to pick up the slack—sometimes with internal promotions, sometimes with limited new hires. In addition, the IRS employs thousands of seasonal employees during the filing season and for other limited tasks throughout the year. And even employees who do not change jobs face constant changes in the nature of their workloads. For example, as the problem of tax-related identity theft has increased, the IRS has had to train and assign thousands of employees to work in that area.

The IRS has tried to train employees at lower cost by replacing in-person training with remote instruction. That is a constructive approach to a point. Some types of training can effectively be provided remotely. But other types, such as teaching taxpayer facing employees how to interview taxpayers and working through case studies, do not lend themselves well to a virtual setting. In addition, employees of many IRS functions are spread around the country, and it is difficult for IRS managers to do their jobs properly if they cannot meet periodically—face to face—with the employees they supervise. In my view, it is impossible to cut the IRS's training budget by 83 percent without impairing the ability of IRS employees to perform their jobs effectively.

The IRS, pursuant to a Treasury Department directive, has implemented new rules that require executives who manage the major IRS functions, myself included, to obtain prior approval from the Deputy Commissioner for any training (or other event) that will cost *$3,000* or more.[24] As a practical matter, this low threshold has made most in-person meetings impossible. Considering the costs of airfare, local transportation, hotel accommodations, and per diem reimbursements, attendance by more than two persons in many cases will generate costs above $3,000. By analogy, these rules are akin to requiring Senators and their staffs to obtain advance written permission from the Majority Leader before visiting the States they represent, including their State offices, or attending any conferences outside Washington, DC—on the theory that "virtual" town halls are just as effective as being there. The quality of the communication is simply not equivalent. My own organization, the Taxpayer Advocate Service, used to provide a rigorous 1-week training session each year for all of our employees. It is not reasonable to expect employees to sit in front

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[21] In our past annual reports, we have written about local compliance initiatives the IRS has undertaken that include integrated enforcement and outreach and education components. *See, e.g.,* National Taxpayer Advocate 2008 Annual Report to Congress 176–192 (Most Serious Problem: *Local Compliance Initiatives Have Great Potential but Face Significant Challenges*). One example: In the early 1990s, the IRS launched an initiative designed to address noncompliance by fishermen in Alaska that resulted from confusion as well as community norms and attitudes. The IRS combined stepped up enforcement activities with an extensive outreach and education campaign in remote fishing villages and on fishing vessels that included assisting with tax return preparation and training local volunteers to assist taxpayers. By the end of the initiative, the number of nonfilers among the target population declined by 30 percent. *Id.* at 177–178.

[22] IRS Integrated Financial System, Commitments, Obligations, Expenditures & Disbursements report. These figures track employees in "pay status" and exclude employees who were on Leave Without Pay or related statuses.

[23] IRS Fact Sheet, FS–2013–05, *IRS Achieves $1 Billion in Cost Savings and Efficiencies* (April 2013), *at* http://www.irs.gov/uac/IRS-Achieves-$1-Billion-in-Cost-Savings-and-Efficiencies (last visited April 12, 2013). From fiscal year 2010 to fiscal year 2012, the IRS already cut its training budget from about $168 million to about $63 million, a reduction of 62 percent. IRS Integrated Financial System, Commitments, Obligations, Expenditures & Disbursements report.

[24] *See* Interim Guidance Memorandum, Control No. CFO–01–1212–01 (Dec. 27, 2012) (issued pursuant to Treasury Directive 12–70 (Nov. 28, 2012), *at* http://www.treasury.gov/about/role-of-treasury/orders-directives/Pages/td12-70.aspx). The Deputy Commissioner herself can only approve training and travel up to $24,999. Any training or travel over that threshold must be sent to the Treasury Department for approval.

of a computer screen for a full week and absorb the same level of information they would receive from classroom presentations, interactive case studies, and discussions.

Nor has it become easier to provide remote instruction. One major alternative to in-person meetings is the use of the IRS's production studio at the New Carrollton Federal Building, where trainings can be taped and then made available to employees wherever they work. The Acting IRS Commissioner has stated: "Utilizing the production studio allows the IRS to provide education and training to large audiences, both within the IRS and to the public, often while reducing travel and other costs associated with such programs." [25] I share his view that the production studio is an appropriate and low-cost alternative to in-person meetings for some types of training, yet the IRS has imposed stringent approval requirements on all virtual training sessions that utilize the production studio. Specifically, the IRS leadership has directed that "no videos should be produced until further notice unless the project has been reviewed by the Video Editorial Board and approved by the business unit head of office and the Deputy Commissioner for Operations Support." [26]

With the frequency of changes in the tax law, the concomitant need to reiterate taxpayer rights protections, the need to train new employees and those promoted to new positions, the use of thousands of seasonal employees, the dramatic expansion in tax-related identity theft, and the ongoing preparations to administer the tax provisions of the Patient Protection and Affordable Care Act, IRS employees desperately need top notch training and updates to enable them to do their jobs. Rather than facilitating training, the IRS has imposed a series of roadblocks that, from a taxpayer perspective, mean that employees often will not have the information they need to make the right decisions, accurately answer taxpayer inquiries, or adequately protect taxpayer rights.

CONCLUSION

For the reasons I have described, I believe it is time for this subcommittee and others to give serious thought to the way the IRS is funded and consider changing the budget rules to reflect the IRS's unique role as the agency that collects Federal revenue. For almost all other programs, a reduction in funding helps to reduce the Federal budget deficit. For the IRS, a reduction in funding increases taxpayer noncompliance and ultimately increases the deficit. The budget rules today do not reflect that dichotomy, but they should. Therefore, I believe that as a first step the IRS budget should be fenced off from future across-the-board cuts and from the effects of the current sequester. Over the longer term, I encourage this subcommittee to find a way to set IRS funding levels in a manner that focuses on maximizing revenue collection, with due regard for protecting taxpayer rights and minimizing taxpayer burden, outside the zero-sum game limitations imposed by the section 302(b) allocations.

When we require U.S. citizens and others to pay over a large percentage of their incomes to the government, we have an obligation to make the process as painless as possible. The IRS must be funded at a level that enables it to provide necessary taxpayer assistance and to enforce the laws, both to raise the revenue the government requires and to provide compliant taxpayers with assurance that others are paying their fair share. I am deeply concerned that recent cuts to the IRS budget are jeopardizing its ability to carry out this vital mission.

PREPARED STATEMENT OF THE NATIONAL TREASURY EMPLOYEES UNION

Chairman Lautenberg, Ranking Member Johanns and distinguished members of the subcommittee, I would like to thank you for allowing me to provide comments on the administration's fiscal year 2014 budget request for the Internal Revenue Service (IRS) and the impact that recent budget cuts and sequestration have had on the agency. As president of the National Treasury Employees Union (NTEU), I have the honor of representing more than 150,000 Federal workers in 31 agencies, including the men and women at the IRS.

[25] Letter from Steven T. Miller, Acting Commissioner of Internal Revenue, to Hon. Charles Boustany Jr., M.D., Chairman, Subcommittee on Oversight, House Committee on Ways and Means (March 4, 2013).

[26] Memorandum from Beth Tucker, Deputy Commissioner, Operations Support, to Senior Executive Team, Additional Information on Video Production (March 7, 2013). The approval requirements are an understandable response to criticism the agency received for an over-the-top video that included a parody of *Star Trek*. When taken together with other training restrictions, however, the net effect is that employees will not have the knowledge to do their jobs properly.

INTERNAL REVENUE SERVICE FISCAL YEAR 2014 BUDGET REQUEST

Mr. Chairman, NTEU strongly supports the administration's fiscal year 2014 budget request of $12.8 billion for the IRS that would restore funding for important taxpayer service and enforcement activities that has been slashed in recent years. These funding reductions have adversely impacted IRS' ability to meet its mission, and without action by the Congress, IRS' ability to serve taxpayers and enforce our Nation's tax laws will continue to erode.

IMPACT OF RECENT CUTS TO INTERNAL REVENUE SERVICE BUDGET

Mr. Chairman, 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 reduced funding in recent years and the cuts mandated by sequestration.

Since fiscal year 2011, the IRS budget has been reduced by almost $1 billion due to a cut of $305 million for fiscal year 2012 and more than $600 million under sequestration. The funding reductions have forced the IRS to operate under an exception-only hiring freeze since December 2010, and have forced the IRS to reduce the total number of full-time, permanent employees by 8,000 since the end of fiscal year 2010, more than 5,000 of which are front-line enforcement employees. The lack of sufficient staffing has strained IRS' capacity to carry out its important taxpayer service and enforcement missions.

In addition, the cuts mandated by sequestration will force the IRS to furlough all of its employees between 5 and 7 days, further hampering IRS' ability to meet its mission. According to the IRS, the sequester cuts to operating expenses and furloughs of IRS employees will result in the inability of millions of taxpayers to get answers from IRS call centers and taxpayer assistance centers and will significantly delay IRS responses to taxpayer letters.

The funding cuts will also reduce IRS' capacity to generate critical revenue for the Federal Government. According to the IRS, every $1 invested in the IRS enforcement programs generates roughly $7 in return. Thus, a $600 million reduction to IRS' budget for fiscal year 2013 will result in the loss of more than $4 billion in revenue this fiscal year alone. That lost revenue could otherwise be invested in critical government programs or used to reduce the Federal deficit.

The drastic cuts to IRS' budget come at a time when the IRS workforce is already facing a dramatically increasing workload with staffing levels down by 10,000 from 2 years ago, and more than 20 percent less than what they were just 15 years ago. In 1995, the IRS had a staff of 114,064 to administer tax laws and process 205 million tax returns. By 2012, staffing had fallen to 90,711 to administer a more complicated tax code and process 236 million much more complex tax returns. For this year's tax-filing season, the IRS is operating with 8,000 fewer employees than just 2 years ago.

IMPACT ON ENFORCEMENT

Mr. Chairman, NTEU believes that the recent funding cuts to IRS' budget have greatly impaired its' ability 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 fiscal year 2012, on a budget of $11.8 billion, the IRS collected $2.52 trillion, roughly 93 percent of Federal Government receipts. This means that, for every $1 that the Congress appropriated for the IRS, the IRS collected about $214 in return.

However, reductions in enforcement funding in fiscal year 2011 and fiscal year 2012 have undermined IRS' ability to maximize taxpayer compliance and bring in much needed Federal revenue. In fiscal year 2012, the IRS generated $50 billion in enforcement revenue, down from $57.6 billion in fiscal year 2010. 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 was reduced by more than 1,500 between 2011 and the end of 2012 and are down more than 20 percent since 1995.

The need for sufficient enforcement staffing is more important than ever. Last 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 owed 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 taxes 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.

COMBATING IDENTITY THEFT

The funding cuts have also impacted IRS' ability to combat the rising incidence of tax-related identity theft, and without sufficient funding, its ability to detect and prevent fraud and assist taxpayers in a timely manner will erode.

According to recent testimony by Nina Olson, the National Taxpayer Advocate, the IRS had more than 1.25 million identity theft cases in its inventory as of the end of February 2013, a drastic increase from 2012, when it had less than 235,000 cases. In addition, with the average current cycle time for resolution of identity theft cases exceeding 6 months, Olson warned the cycle time for resolving these cases may dramatically increase as the inventory of cases continues to grow.

Despite insufficient resources, the IRS is doing what it can to prevent and investigate identify theft crimes and help victims. Currently, more than 3,000 IRS employees are working on identity theft, more than double the number during the previous filing season. In addition, IRS has trained 35,000 employees that work with taxpayers to help them better recognize identity theft and assist victims. In addition, despite budget reductions of more than $1 billion over the past 2 years which has reduced staffing levels by more than 8,000, the IRS is continuing to dedicate staff to preventing identity theft and assisting victims, and in fiscal year 2012 spent roughly $328 million on refund fraud and identity theft efforts. These investments helped the IRS protect $20 billion of fraudulent refunds, including those related to identity theft during fiscal year 2012, compared with $14 billion in fiscal year 2011. But due to the rapidly growing nature of identity theft, it will be impossible for the IRS to keep pace without additional resources.

That is why NTEU was happy to see the administration's budget request would provide a $360 million increase in funding for IRS tax enforcement more than the fiscal year 2012 enacted level, including funding for programs designed to protect revenue by identifying fraud and preventing issuance of questionable refunds including tax-related identity theft. In particular, the budget request would provide $101 million to improve identification and prevention of refund fraud identity theft, protect taxpayers' identities and assist victims of identity theft. This funding will support 850 new full-time equivalents, and is projected to protect $1.3 billion in revenue, once the new hires reach full potential in fiscal year 2016, a protected revenue return on investment (ROI) of $14.4 to $1.

NTEU also strongly supports the administration's request for an additional $412 million in enforcement funding for fiscal year 2014 through a program integrity cap adjustment for high revenue generating enforcement activities. This $412 million in funding, coupled with additional investments through 2023, 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 $32.7 billion in net savings over 10 years.

IMPACT ON TAXPAYER SERVICES

In addition to hampering IRS' ability to enforce tax laws and maximize taxpayer compliance, funding cuts in the past few years have hurt IRS efforts to provide taxpayers with the assistance they need in a timely manner. As you may know, demand for telephone service remained extremely high in fiscal year 2012 as more taxpayers called the IRS to resolve tax account issues and to request installment packages. Assisting these taxpayers earlier in the tax administration process through taxpayer service venues, rather than through more costly compliance activities, allows the IRS to resolve customer inquiries more quickly and cost-effectively. The significant increase in call demand stressed existing resources which negatively impacted the level of service. According to IRS, in fiscal year 2012, the IRS handled 68 percent of calls, with an average wait time of 17 minutes on hold. In 2004, it answered 87 percent of calls, with an average wait time of 2½ minutes.

A lack of adequate resources is also impacting IRS efforts to assist taxpayers during the current filing season, which was delayed until January 30 for most taxpayers due to late congressional action on year-end tax legislation. According to the IRS, because it has been forced to dedicate staff and resources to the most essential areas, it has had to commit staff to resolving identity theft cases, at the cost of having fewer people on its toll-free taxpayer service line. This has prevented IRS from answering 3 out of every 10 calls it receives from taxpayers seeking to speak to a telephone assister, and resulted in wait times in excess of 13 minutes for those that are able to get through.

NTEU believes that without the additional funding proposed in the administration's budget request, 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.

That is why we strongly support the President's request of $2.4 billion for taxpayer services which will enable the IRS to improve the responsiveness and accuracy of taxpayer service, and support IRS efforts to enhance taxpayer compliance.

CONCLUSION

Mr. Chairman, thank you for the opportunity to provide NTEU's views on the administration's fiscal year 2014 budget request for the IRS. NTEU believes that only by restoring critical funding for effective enforcement and taxpayer service programs can the IRS provide America's taxpayers with quality service while maximizing revenue collection that is critical to reducing the Federal deficit.

Senator MIKULSKI. Thank you, Commissioner.

Mr. George, we'd like to also hear from you now, sir.

STATEMENT OF HON. J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Mr. GEORGE. Thank you, Madam Chairwoman. Madam Chairwoman Mikulski, Ranking Member Johanns, and Senator Udall: Thank you for the opportunity to testify on the IRS's fiscal year 2014 budget request, our recent work related to the most significant issues currently confronting the IRS, and the fiscal year 2014 budget request for the Treasury Inspector General for Tax Administration, also referred to as "TIGTA."

The proposed IRS budget requests appropriated resources of approximately $12.9 billion. This is an increase of slightly more than $1 billion from fiscal year 2012 enacted levels. ACA contains an extensive array of tax law changes that will present many challenges for the IRS in the coming years. The IRS's fiscal year 2014 budget request includes additional funding of $440 million for the ACA and, while the Department of Health and Services (HHS) will take the lead in developing the policy provisions of the act, the IRS will administer the law's numerous tax provisions.

The development and implementation of new systems for the ACA provisions presents major information, technology, management challenges. These include rapid implementation of interdependent projects that require extensive coordination within the IRS and with other Federal agencies.

One key healthcare provision takes effect December 31 of this year. This provision is the requirement for individuals to maintain minimum essential healthcare coverage or face a continuous penalty. Starting in calendar year 2014, the IRS will be responsible for implementing the premium assistance tax credit as well as implementing the penalty on applicable individuals for each month that they fail to have minimum essential coverage.

These two issues have a far-reaching impact on the IRS and will require significant resources to design and build the new computer systems and prepare for increased customer service as taxpayers turn to the IRS with questions and issues about the ACA and their tax and health insurance requirements.

Customer service has been declining in recent years, with fewer taxpayers being served at their local offices and the IRS answering fewer telephone calls. The ACA will further stretch these already limited resources at the IRS.

A serious challenge confronting the IRS is the tax gap, which is defined as the difference between the estimated amount taxpayers owe and the amount that they voluntarily and timely pay for a tax year. The most recent gross tax gap estimate developed by the IRS was $450 billion for tax year 2006 and that's $450 billion each year.

The following are examples of strategies that could help improve tax compliance: Enhancing information reporting by third parties to the IRS could reduce evasion and help taxpayers comply voluntarily. However, identifying additional reporting opportunities can be challenging because third parties may not have accurate information that is readily available. Also, adding reporting requirements creates a burden for both third parties as well as the IRS.

To determine the appropriate level of enforcement resources, the IRS would need to consider how to balance taxpayer service and enforcement and how productively it uses its resources. We reviewed enforcement trends and noted that in fiscal year 2007 the IRS collected more than $59 billion in taxes, penalties, and interest. In fiscal year 2012, dollars collected decreased to approximately $50 billion.

There are two new systems that will help the IRS reduce the tax gap. One is a system that will automatically match business return filings to third-party information returns in two areas, merchant payment cards and cost basis reporting on the sale of securities.

The other system, which was referred to by Mr. Miller, will match the Foreign Account Tax Compliance Act, FATCA, information reported by financial institutions in foreign countries and U.S. citizens regarding offshore bank accounts.

Simplifying the tax code could help taxpayers understand and voluntarily comply with their tax obligations and limit opportunities for tax evasion.

Incidents of identity theft have continued to rise since 2011 when the IRS again identified more than 1 million incidents. In 2012, the IRS identified almost 1.8 million incidents. The IRS has placed emphasis on this area over the past year, but there is still work to be done. Emphasis on this area over the past year—TIGTA identified 1.5 million undetected tax year 2010 returns with characteristics of identity theft and $5.2 billion in refunds that were inappropriately issued.

The IRS administers numerous refundable tax credits. The most significant refundable credit is the earned income tax credit, which the IRS reported improper payments of $12 billion to $14 billion in fiscal year 2012. Two other refundable credits include the additional child tax credit and the American opportunity tax credit, also referred to as "the education credit."

TIGTA found that if the IRS freezes a questionable earned income tax credit claim it will later disallow the additional child tax credit claim 67 percent of the time. The IRS could have prevented $419 million in erroneous additional child credits had it reviewed the child credit at the same time as the earned income tax credit.

TIGTA also reported that as of May 2010 more than 2 million taxpayers received $3.2 billion in potentially erroneous refunds for the education credit.

As demand for taxpayer services continues to rise, resources have decreased, thereby affecting the quality of customer service that the IRS is able to provide. In September 2012, TIGTA reported that an increase in call demand and limited resources continue to adversely affect the IRS's level of service for its toll-free telephone lines.

Continued enforcement on human capital remain important. More than one-third of all executives and almost 20 percent of non-executive managers are currently eligible for retirement. Within 5 fiscal years nearly 70 percent of all IRS executives and nearly one-half of the managers are projected to be eligible for retirement. Overall 40 percent of the IRS's employees will be retirement-eligible within 5 fiscal years.

Finally, Madam Chairwoman, TIGTA's budget, as you requested information on, includes mitigating risks associated with modernization, security over taxpayer data and employees, procurement fraud, the tax gap, implementing major tax law changes, and human capital challenges confronting both the IRS as well as TIGTA.

In addition to responding to the growing number of threats against IRS employees, we will continue to put that as a priority. Recent audit work uncovered inefficient use of resources by the IRS concerning air cards, wireless cards allowing for wireless computer services, and BlackBerry use, smartphones, and shortcomings in the IRS's compliance with the Improper Payments Elimination and Recovery Act, and imperfections in the way the IRS refers and recognizes indications of fraud.

PREPARED STATEMENT

Furthermore, TIGTA has determined that the IRS could develop or improve processes that will increase its ability to detect and prevent the issuance of fraudulent refunds resulting from identity theft.

Madam Chairwoman, Ranking Member Johanns, and Senator Udall, thank you for the opportunity to share my views and I'm happy to address any questions that you may have.

[The statement follows:]

PREPARED STATEMENT OF HON. J. RUSSELL GEORGE

Chairman Lautenberg, Ranking Member Johanns, and members of the subcommittee, thank you for the opportunity to testify on the Internal Revenue Service's (IRS) fiscal year [1] 2014 budget request, our recent work related to the most significant challenges currently facing the IRS, and the Treasury Inspector General for Tax Administration's (TIGTA) fiscal year 2014 budget request.

TIGTA is a nationwide organization. We are statutorily mandated to provide independent audit, investigative, and inspection and evaluation services necessary to improve the quality and credibility of IRS operations, including the oversight of the IRS Chief Counsel and the IRS Oversight Board. TIGTA's oversight activities are explicitly designed to identify high-risk systemic inefficiencies in IRS operations and to investigate weaknesses in tax administration. TIGTA's role is critical to providing America's taxpayers with assurance that the approximately 99,300 [2] IRS employees who collect more than $2.1 trillion in tax revenue each year, process more than 147 million individual tax returns, and issue $333 billion in tax refunds, do so in an effective and efficient manner while minimizing the risks of waste, fraud, and abuse.

[1] The Federal Government's fiscal year begins on October 1 and ends on September 30.
[2] Total IRS staffing as of March 23, 2013.

TIGTA's Office of Audit (OA) reviews all aspects of the IRS tax administration system and provides recommendations to: Improve IRS systems and operations, ensure the fair and equitable treatment of taxpayers, and prevent and detect waste, fraud, and abuse. OA places audit emphasis on high-risk areas, statutory mandates, as well as areas of concern to the Congress, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other key stakeholders. These reviews have covered such significant issues as identity theft, refund fraud, improper payments, security vulnerabilities, complex modernized computer systems, tax collections and revenue, and waste and abuse in IRS operations.

TIGTA's Office of Investigations (OI) protects the integrity of the IRS by investigating allegations of IRS employee misconduct, external threats to employees and facilities, and attempts to impede or otherwise interfere with the IRS's ability to collect taxes. Misconduct by IRS employees manifests itself in many ways, including extortion, theft, taxpayer abuses, false statements, financial fraud, and identity theft.

TIGTA OI has the unique statutory responsibility to protect the IRS by identifying, investigating, and responding to threats against IRS employees located in more than 670 IRS facilities located nationwide. Threats and assaults directed at IRS employees, facilities, and critical infrastructure impede the effective administration of the Federal tax system. Contact with the IRS at times can be stressful for taxpayers, and over the last several years, taxpayers have become more confrontational and on occasion violent, when they interact with the IRS.

The threat environment confronting the IRS is significant. Over the past three fiscal years, TIGTA has processed more than 8,600 threat-related complaints that resulted in more than 4,000 investigations. These investigations resulted in 67 criminal prosecutions and identification of 2,800 people as potentially harmful to IRS employees. Two examples include a taxpayer who flew an airplane into a building that contained an IRS office in 2010 and the three individuals arrested in Atlanta in 2011 for conspiring to blow up Federal facilities, including IRS offices.

TIGTA will continue to place a priority on ensuring the safety and security of IRS employees and facilities. We will review and respond to intelligence information relating to potential violent acts against IRS employees and facilities and develop proactive leads to investigate and mitigate potential threats. In addition, investigators will respond to violent acts committed against IRS employees and facilities and will work towards the arrest, conviction, and sentencing of the perpetrators.

OVERVIEW OF THE IRS'S FISCAL YEAR 2014 BUDGET REQUEST

The IRS is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. The IRS's budget request supports the Department of the Treasury's goals to pursue comprehensive tax and fiscal reform and to manage the Government's finances in a fiscally responsible manner. The IRS supports these goals through its strategies of increasing voluntary tax compliance and increasing the number of electronic transactions with the public. The IRS strives to enforce the tax laws fairly and efficiently while balancing service and education to promote voluntary compliance and reduce taxpayer burden. The IRS's role is unique within the Federal Government in that it collects the revenue that funds the Government and administers the Nation's tax laws. It also works to protect Federal revenue by detecting and preventing the growing risk of fraudulent tax refunds and other improper payments.

To achieve these goals, the proposed fiscal year 2014 IRS budget requests appropriated resources of approximately $12.9 billion.[3] The total appropriations amount is an increase of slightly more than $1 billion, or approximately 9 percent more than the fiscal year 2012 enacted level of approximately $11.8 billion. This increase is illustrated in Table 1. The budget request includes a net staffing increase of 4,572 full-time equivalents (FTEs)[4] for a total of approximately 96,200 appropriated FTEs. The IRS is operating under a Continuing Resolution[5] for fiscal year 2013;

[3] The FY 2014 budget request also includes approximately $111 million from reimbursable programs, $278 million from user fees, $114 million in available multi-year/no-year funds, and a transfer out to the Alcohol and Tobacco Tax and Trade Bureau of $5 million for a total amount of $13.4 billion in available resources. Multi-year funds are made available for a specific time period of more than one fiscal year. No-year funds do not have a specific time period that the funds must be spent by and are available until the objectives of the program have been achieved.

[4] A full-time employee working 40 hours per week for 52 weeks.

[5] A continuing resolution provides temporary funding for the period of time specified in the continuing resolution.

however, this funding was reduced by $618 million as a result of the sequestration[6] and rescission.[7]

TABLE 1.—IRS FISCAL YEAR 2014 BUDGET REQUEST INCREASE OVER FISCAL YEAR 2012 ENACTED BUDGET

[In thousands of dollars]

Appropriations Account	Fiscal Year 2012 Enacted	Fiscal Year 2014 Request	Amount Change	Percentage Change
Taxpayer Services	$2,239,703	$2,412,756	$172,873	7.72
Enforcement	5,299,367	5,666,787	367,420	6.93
Operations Support	3,947,416	4,480,843	533,427	13.51
Business Systems Modernization	330,210	300,827	(29,383)	−8.90
Total Appropriated Resources	11,816,696	12,861,033	1,044,337	8.84

Source: TIGTA analysis of IRS's Fiscal Year 2014 Budget Request, Operating Level Tables.

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

FUNDING RELATED TO IMPLEMENTING THE ACA PROVISIONS

The Patient Protection and Affordable Care Act of 2010[8] and the Health Care and Education Reconciliation Act of 2010 that made amendments to it (collectively referred to as the "ACA") contains an extensive array of tax law changes that will present many challenges for the IRS in the coming years. The ACA provisions provide incentives and tax breaks to individuals and small businesses to offset health care expenses. They also impose penalties, administered through the tax code, for individuals and businesses that do not obtain health care coverage for themselves or their employees.

While the Department of Health and Human Services (HHS) will take the lead in developing the policy provisions of the Act, the IRS will administer the law's numerous tax provisions. The IRS estimates that the ACA includes approximately 50 tax provisions, at least eight of which will require the IRS to build new computer applications and business processes that do not exist within the current tax administration system.

In June 2012, we reported that appropriate plans had been developed to implement tax-related provisions of the ACA using well-established methods for implementing tax legislation. The IRS's plans addressed tax forms, instructions, and most of the affected publications, as well as employee training, outreach and guidance to taxpayers and preparers, computer programming, and the compilation of additional data to enforce compliance with various ACA provisions.

In fiscal year 2012, the IRS received $299 million from the Health Insurance Reform Implementation Fund (HIRIF) to support an additional 664 FTEs. The HIRIF is administered by the Department of Health and Human Services as provided for in the Health Care and Education Reconciliation Act of 2010 to carry out the ACA. This was in addition to the funding received by the IRS based on its enacted budget.

The IRS informed TIGTA that it does not anticipate receiving any funding from the HIRIF after fiscal year 2012. The IRS also informed TIGTA that its fiscal year 2013 spending plan includes $360 million to implement the ACA in fiscal year 2013. Since the IRS will not be reimbursed from the HIRIF for 2013, all fiscal year 2013 ACA spending is funded from the IRS's operating budget.

The IRS's fiscal year 2014 budget request includes additional funding of $440 million to provide 1,954 FTEs for continued efforts related to the implementation of the

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[6] Sequestration involves automatic spending cuts of approximately $1 trillion across the Federal Government that took effect on March 1, 2013.

[7] A rescission cancels part of an agency's discretionary budget authority and is usually established as a percentage reduction to the budget authority.

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

ACA. The largest component of this increase is $306 million for the implementation of the information technology changes needed to deliver tax credits and other requirements.

The development and implementation of new systems for the ACA provisions present major information technology management challenges. These include rapid implementation of interdependent projects that require extensive coordination within the IRS and with other Federal agencies. For example, one new system is the Income and Family Size Verification project, which uses tax return data to verify household income and family size for each person applying for health care coverage. TIGTA found that the IRS was generally managing system risks and made recommendations to improve the system development process.[9]

One key healthcare provision takes effect December 31, 2013. This provision is the requirement for individuals to maintain minimum essential health care coverage[10] or face a continuous penalty. Starting in Calendar Year 2014, the IRS will be responsible for implementing the Premium Assistance Tax Credit[11] as well as implementing the penalty on applicable individuals for each month they fail to have minimum essential coverage. These two issues have a far-reaching impact on the IRS and will require significant resources, particularly customer service resources, as taxpayers turn to the IRS with questions and issues about the ACA and their tax and health insurance requirements. Customer service has been declining in recent years, with fewer taxpayers being served at the local offices and the IRS answering fewer telephone calls. The ACA will further stretch these already limited resources at the IRS.

SELECTED SIGNIFICANT ISSUES FACING THE IRS

As requested by the subcommittee, in this section of my testimony, I will examine several of the most significant challenges now facing the IRS as it administers the Nation's tax laws.

IRS TAX GAP

A serious challenge confronting the IRS is the Tax Gap, which is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a Tax Year. The most recent gross Tax Gap estimate developed by the IRS was $450 billion for TY 2006. In comparison, the gross Tax Gap was estimated at $345 billion for TY 2001. The $450 billion Tax Gap estimate for 2006 is the best approximation of noncompliance the IRS can provide. However, it is important to note that because of the methods that are used, a significant portion of the Tax Gap is inferred. The voluntary compliance rate[12] decreased slightly from 83.7 percent in 2001 to 83.1 percent in 2006. Figure 2 shows the IRS's latest Tax Gap Map illustrating the various components of the Tax Gap.

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[9] TIGTA, Ref. No. 2013–23–034, *Affordable Care Act: The Income and Family Size Verification Project Is Applying a New Iterative Systems Development Process* (Mar. 2013).

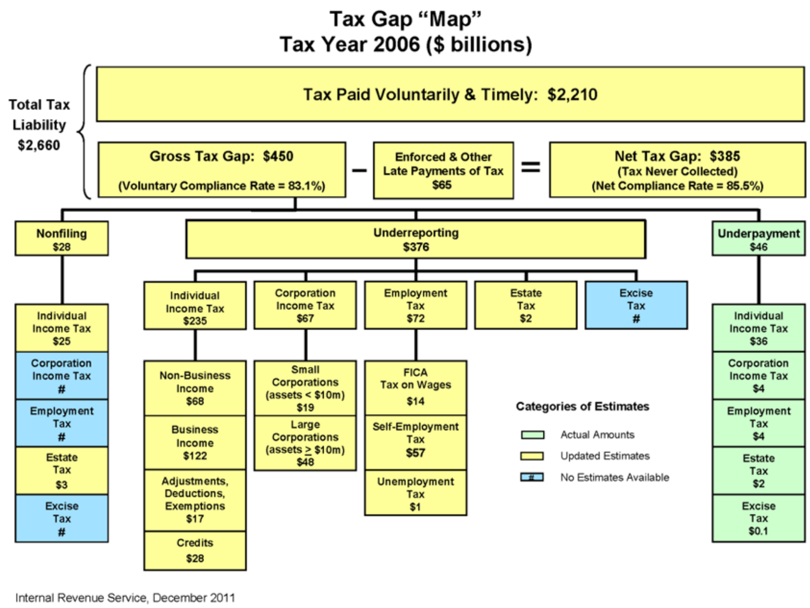
[10] The type of coverage an individual needs to have to meet the individual responsibility requirement under the Affordable Care Act.

[11] The Premium Assistance Tax Credit provides a refundable tax credit that eligible taxpayers can use to help cover the cost of health insurance premiums for individuals and families who purchase health insurance through a State health benefit exchange.

[12] The voluntary compliance rate is the amount of true tax liability imposed by law for a given tax year that is paid voluntarily and timely by the taxpayer.

FIGURE 2.—Tax Gap "Map"
Tax Year 2006

[Dollars in billions]



SOURCE.—Internal Revenue Service, December 2011

Reducing the Tax Gap is an IRS priority. For example, in September 2006, the Treasury Department's Office of Tax Policy published "A Comprehensive Strategy for Reducing the Tax Gap." The 2006 report provided a seven-component strategy for reducing the Tax Gap. The components of that strategy are to:

—reduce opportunities for evasion;
—make a multi-year commitment to research;
—continue improvements in information technology;
—improve compliance activities;
—enhance taxpayer service;
—reform and simplify the tax law; and
—coordinate with partners and stakeholders.

In July 2009, the Treasury Department completed a report on the Tax Gap that identified detailed strategic priorities, compliance program accomplishments, planned actions and legislative proposals.[13] Notwithstanding this well-laid plan, reducing the Tax Gap and improving voluntary compliance are an ongoing challenge that requires a multi-faceted approach.

More recently, the Government Accountability Office issued its Tax Gap report,[14] stating that because noncompliance has multiple causes and spans different types of taxes and taxpayers, multiple approaches are needed to reduce the Tax Gap.

TIGTA has also identified several concerns with both estimating the Tax Gap and efforts to reduce it. For example, while the IRS has not developed an estimate for the international portion[15] of the Federal Tax Gap, non-IRS estimates of the inter-

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[13] The Department of the Treasury, "Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance." July 2009. Available at http://www.irs.gov/pub/newsroom/tax_gap_report_-final_version.pdf.

[14] Government Accountability Office, Ref. No. GAO 12–651T, *Tax Gap: Sources of Noncompliance and Strategies to Reduce It* (Apr. 2012).

[15] The international Tax Gap is defined as taxes owed—but not collected on time—from a U.S. person or foreign person whose cross-border transactions are subject to U.S. taxation.

national Tax Gap range from $40 billion to $123 billion.[16] Another concern about the IRS's methods to estimate the size of the Tax Gap is that the various sample sizes used in the employment tax study may be insufficient to determine compliance levels.[17]

The following strategies could help improve tax compliance:

—*Information Reporting*.—Enhancing information reporting by third parties to the IRS could reduce tax evasion and help taxpayers comply voluntarily. However, identifying additional reporting opportunities can be challenging because third parties may not have accurate information that is readily available. Also, adding reporting requirements creates a burden for both third parties and the IRS.

The IRS has developed a strategy and vision to explore more "real time" or upfront matching of tax returns when they are first filed with the IRS instead of the traditional "look back" model of compliance. If the tax return contains information that does not match the IRS's records, the IRS could provide the taxpayer the opportunity to fix his or her tax return before it is accepted. It would also enable the IRS to identify and prevent a significant number of fraudulent refund claims based on false W–2 data.

—*Taxpayer Service*.—Ensuring high-quality services to taxpayers, such as by telephone and correspondence or online, can help encourage those taxpayers who wish to comply with tax laws but do not understand their tax obligations. However, tax law changes and funding priorities have recently affected the IRS's ability to provide quality taxpayer services.

TIGTA reported that taxpayers are increasing their use of customer assistance tools; however, budget cuts and staffing shortages prevented the IRS from properly meeting its Level of Service[18] goals for fiscal year 2012. As a result, taxpayers waited longer on the IRS's toll-free telephone assistance lines. In addition, tax return preparation was provided only on a limited number of days per week and only on a first-come, first-served basis at Taxpayer Assistance Centers.[19]

—*Enforcement*.—Devoting additional resources to enforcement could enable the IRS to contact the millions of potentially noncompliant taxpayers it identifies but cannot contact due to resource limitations. To determine the appropriate level of enforcement resources, policymakers would need to consider how to balance taxpayer service and enforcement activities and how effectively and efficiently the IRS currently uses its resources. We reviewed enforcement revenue trends and noted that in fiscal year 2007, the IRS collected over $59 billion in taxes, penalties and interest, but the dollars collected dropped over the next 2 years before increasing again in fiscal year 2010. Subsequently, dollars collected decreased to slightly more than $50 billion in fiscal year 2012. While the IRS did not track the reason for the increase in fiscal year 2010, the IRS did receive additional funds to hire more than 1,500 revenue officers from June 2009 to February 2010.

IRS statistics show that 50 percent of the partnership returns[20] audited after being selected by the Discriminant Index Function (DIF) system,[21] or related to a DIF-selected return, were closed as a no-change in fiscal year 2011. The IRS has relied on this system to decide how to best allocate its audit resources. According to the IRS, a high no-change rate means the IRS is spending a significant amount of resources on unproductive audits and compliant taxpayers are unnecessarily burdened by audits. TIGTA reported that the IRS should pursue alternative audit selection techniques by using existing databases con-

[16] TIGTA, Ref. No. 2009–IE–R001, *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap* (Jan. 2009).

[17] TIGTA, Ref. No. 2011–10–034, *Limitations in the Sample Size for the Internal Revenue Service's Employment Tax Study May Impact Ability to Determine Compliance Levels* (May 2010).

[18] The IRS's Level of Service measure reflects the percentage of taxpayers who call for live assistance on the Customer Service's toll-free telephone lines and speak with an assistor.

[19] TIGTA, Ref. No. 2012–40–119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sep. 2012).

[20] Form 1065, *U.S. Return of Partnership Income,* is an information return used to report the income, gains, losses, deductions, credits, etc., from the operation of a partnership. A partnership does not pay tax on its income but "passes through" any profits or losses to its partners.

[21] The DIF system uses computer formulas to classify tax returns for examination potential by assigning weights to certain basic tax return characteristics and scoring the tax return. The higher the score, the higher the probability of significant tax change as a result of the examination.

taining partnership data to help identify additional productive returns for audit.[22]

The IRS approach to International Tax Administration includes an initiative to identify and develop baselines and measures to better assess the international Tax Gap and progress in reducing it. The Foreign Account Tax Compliance Act (FATCA) is an important development in U.S. efforts to improve tax compliance involving foreign financial assets and offshore accounts. The changes required by the FATCA will combat tax evasion by U.S. persons holding investments in offshore accounts, expand the IRS global presence, and pursue international tax and financial crimes. Prior to the enactment of the FATCA, the IRS did not have a system to detect offshore tax evasion. The IRS's development of a new FATCA system is a major Information Technology investment for the IRS and is critical for the IRS to ensure international tax compliance. TIGTA plans to review the development of this critical system and the operation of FATCA once implemented.

—*Compliance Checks*.—Expanding compliance checks before the IRS issues refunds would involve matching information returns to tax returns during, rather than after, the tax filing season. This approach would require a major reworking of some fundamental IRS computer systems but could help address identity theft-related fraud and allow the IRS to use enforcement resources on other compliance problems.

TIGTA reported that the IRS took a number of additional steps for the 2012 Filing Season[23] to detect identity theft tax refund fraud before it occurred.[24] These efforts included designing new identity theft screening filters[25] that the IRS indicates will improve its ability to identify false tax returns before the tax return is processed and before a fraudulent tax refund is issued. In addition, beginning in Processing Year[26] 2012 the filters use benefit and withholding information from the Social Security Administration (SSA). This information is used to verify that Social Security benefits and related withholding reported on tax returns match the information reported by the SSA. The IRS reports that it identified and confirmed identity theft on over 31,000 tax returns claiming fraudulent Social Security benefits and withholding, and stopped approximately $169 million in fraudulent tax refunds in Processing Year 2012 using the information provided by SSA. The IRS advised us that for the 2013 Filing Season, the filters have been refined and incorporate criteria based on the latest characteristics of confirmed identity theft tax returns.

—*External Parties*.—Leveraging external resources, such as paid tax return preparers and whistleblowers, can help improve tax compliance because paid preparers' actions have an enormous impact on the IRS's ability to effectively administer tax laws. In addition, whistleblowers provide the IRS with information on suspected noncompliance.

TIGTA has reported on the IRS's efforts to improve oversight of the return preparer community.[27] While the IRS began implementing the new preparer requirements in fiscal year 2011, TIGTA reported that it will take years for the IRS to implement the Return Preparer Program, including establishing all of the program requirements and developing the systems and processes necessary to administer and oversee the program. However, this program is on hold based on a recent court ruling. On January 18, 2013, the United States District Court for the District of Columbia ruled that the IRS did not have the authority to regulate tax preparers who had not been regulated before—namely preparers who were not certified public accountants, attorneys, enrolled agents, or enrolled actuaries.[28] On January 23, 2013, the IRS filed a motion to suspend the injunction pending appeal. The U.S. District Court for the District of Columbia denied the IRS's motion but clarified that the IRS is not required to suspend the Preparer Tax Identification Number (PTIN) program, which is one aspect

[22] TIGTA, Ref. No. 2012–30–06, *Despite Some Favorable Partnership Audit Trends, the Number of No-Change Audits Is a Concern* (June 2012).

[23] The period from January through mid-April when most individual income tax returns are filed.

[24] TIGTA, Ref. No. 2012–42–080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

[25] Computer programs designed to detect fraud and improve the IRS's ability to spot false returns before they are processed and refunds are issued.

[26] The calendar year in which the tax return or document is processed by the IRS.

[27] TIGTA, Ref. No. 2010–40–127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (Sep. 2010).

[28] *Loving* v. *IRS*, 2013 U.S. Dist. LEXIS 7980 (D.D.C. Jan. 18, 2013).

of the Return Preparer Program.[29] The IRS filed a notice of appeal to the District of Columbia Circuit Court on February 20, 2013.

The IRS Whistleblower Program also plays an important role in reducing the Tax Gap and maintaining the integrity of a voluntary tax compliance system. However, TIGTA reported that the program continued to have internal control weaknesses on the processing of whistleblower claims. For example, information captured from multiple systems and entered into a single inventory control system was potentially inaccurate, and the quality review process for the new inventory system was not sufficient to ensure that claims were accurately controlled. Additionally, TIGTA determined that timeliness standards for processing claims were not sufficient. Without adequate oversight of the Whistleblower Program, the IRS is not as effective as it could be in responding timely to tax noncompliance issues.[30]

—*Modernization*.—Modernizing information systems could potentially allow the IRS to post more comprehensive tax return information to its computer systems, which could facilitate the examination process and expedite taxpayer contacts for faster resolution.

The IRS considers the Customer Account Data Engine 2 (CADE 2) program critical to the IRS's mission, and it is the IRS's most important information technology investment. TIGTA reported that the implementation of CADE 2 daily processing allowed the IRS to process tax returns for individual taxpayers more quickly by replacing existing weekly processing.[31] The CADE 2 system also provides for a centralized database of individual taxpayer accounts, which will allow IRS employees to view tax data online and provide timely responses to the taxpayers once it is implemented. The IRS's modernization efforts also include the development of computer programs to conduct predictive analytics to reduce refund fraud.[32] The successful implementation of the IRS's modernization program should significantly improve service to taxpayers and enhance Federal tax administration.

—*Simplifying tax return requirements*.—Simplifying the tax code could help taxpayers understand and voluntarily comply with their tax obligations and limit opportunities for tax evasion.

—*Penalties*.—Congress provided numerous penalty provisions in the Internal Revenue Code that the IRS can use to help remedy the noncompliance that contributes to the Tax Gap. The IRS can assess accuracy-related penalties for negligence, substantial understatement of income tax, or substantial valuation misstatement. The IRS estimated that the underreporting of tax contributed $376 billion (84 percent) of the $450 billion total gross Tax Gap, including $235 billion from individual income taxes. To deter this type of behavior, the IRS reported that it assessed more than 500,000 accuracy-related penalties, involving more than $1 billion against individuals during fiscal year 2011.

Penalties are an important tool because they discourage taxpayer behavior that contributes to the Tax Gap. However, the numerous reports TIGTA has issued suggest that the IRS could take better advantage of these tools to deter noncompliance.

For example, TIGTA reported that additional steps must be taken to ensure that examiners properly consider and assess accuracy-related penalties when taxpayers are negligent or understate their tax liabilities by $5,000 or more.[33] A review of 229 audits conducted through the mail found 211 instances (92 percent) where applicable penalties were not considered and assessed. Each of the audits resulted in the taxpayer agreeing they owed additional taxes of at least $5,000. The $5,000 threshold is important because examiners are required to consider assessing an accuracy-related penalty. Since the penalties were not considered and assessed, TIGTA believes opportunities may have been missed to promote compliance among an estimated 9,255 taxpayers over a 5-year period, and to enhance penalty and interest revenue by an estimated $17.5 million.

In another example, TIGTA made several recommendations to help ensure that taxpayers receive fair and consistent treatment by improving how the IRS

[29] *Loving* v. *IRS*, 2013 U.S. Dist. LEXIS 13878 (D.D.C. Feb. 1, 2013).

[30] TIGTA, Ref. No. 2012–30–045, *Improved Oversight Is Needed to Effectively Process Whistleblower Claims* (Apr. 2012).

[31] TIGTA, Ref. No. 2012–20–122, *Customer Account Data Engine 2 System Requirements and Testing Processes Need Improvements* (Sep. 2012).

[32] Computer models that analyze extremely large quantities of data to seek out data patterns and relationships that could indicate potential tax fraud schemes.

[33] TIGTA, Ref. No. 2010–30–059, *Accuracy-Related Penalties Are Seldom Considered Properly During Correspondence Audits* (June 2010).

administered a penalty under Internal Revenue Code Section 6707A.[34] This penalty could be assessed against taxpayers for failing to disclose participation in certain reportable transactions and was enacted to detect, deter, and shut down abusive tax shelter activity. Its importance to the IRS's efforts in combating abusive tax shelters was reflected in the severity of the penalty. The penalty could be as high as $100,000 for individuals and $200,000 for businesses if they fail to disclose participation in specific transactions that the IRS has identified and listed in publications as abusive.

Finally, TIGTA reported that actions could be taken to reinforce the importance of recognizing and investigating fraud indicators during field audits.[35] TIGTA reviewed 116 audits of sole proprietors[36] in which the taxpayer agreed they owed additional taxes of at least $10,000 and found 26 audits with fraud indicators that were not recognized or investigated. As a result, TIGTA believes sole proprietors in some 1,872 audits avoided approximately $19.7 million ($98 million over 5 years) in civil fraud penalties that may have been owed. The fact that fraud indicators were not recognized and investigated in nearly one out of every four of these large-dollar cases is a concern because the omitted income and overstated deductions were substantial.

IDENTITY THEFT AND TAX REFUND FRAUD

Identity Theft

Incidents of identity theft affecting tax administration have continued to rise since calendar year 2011, when the IRS identified more than 1 million incidents of identity theft that impacted our Nation's tax system. As of December 31, 2012, the IRS identified almost 1.8 million incidents during calendar year 2012. This figure includes approximately 280,000 incidents in which taxpayers contacted the IRS alleging that they were victims of identity theft,[37] and more than 1.5 million incidents in which the IRS detected potential identity theft.[38]

In July 2012, TIGTA reported that the impact of identity theft on tax administration is significantly greater than the amount the IRS detects and prevents.[39] Using the characteristics of confirmed identity theft and data that becomes available later in the year, we analyzed tax year 2010 tax returns processed during the 2011 filing season and identified 1.5 million undetected tax returns with potentially fraudulent tax refunds totaling in excess of $5 billion. If not addressed, we estimate that the IRS could issue approximately $21 billion in fraudulent tax refunds resulting from identity theft over the next 5 years.

As a result of the delayed start of this year's filing season, we were unable to determine the extent of identity theft cases this year or compare trends with last year's filing season during our interim filing season audit. However, it is highly likely that incidents of identity theft will show a continued increase when the current filing season results are reported.

Although the IRS is working toward finding ways to determine which tax returns are legitimate, access to third-party income and withholding information at the time tax returns are processed is the single most important tool the IRS could use to detect and prevent identity theft tax fraud resulting from the reporting of false income and withholding. Third-party reporting information would enable the IRS to identify the income as false and prevent the issuance of a fraudulent tax refund. However, most of this information is not available until well after tax return filing begins.[40]

Another important tool that could immediately help the IRS prevent tax fraud-related identity theft is the National Directory of New Hires.[41] However, legislation is needed to expand the IRS's authority to access the National Directory of New Hires wage information for use in identifying tax fraud. Currently, the IRS's use of this information is limited by law to just those tax returns that include a claim

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[34] TIGTA, Ref. No. 2011–30–004, *Penalty Cases for Failure to Disclose Reportable Transactions Were Not Always Fully Developed* (Dec. 2010).

[35] TIGTA, Ref. No. 2012–30–030, *Actions Can Be Taken to Reinforce the Importance of Recognizing and Investigating Fraud Indicators During Field Audits* (Mar. 2012).

[36] A sole proprietor is someone who owns an unincorporated business by himself or herself.

[37] Taxpayers can be affected by more than one incident of identity theft. The 280,000 incidents affected 233,365 taxpayers.

[38] These 1.5 million incidents affected 985,843 taxpayers.

[39] TIGTA, Ref. No. 2012–42–080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

[40] Form W–2, *Wage and Tax Statement,* is an information return containing wage and withholding information for taxpayers. Employers were required to file Forms W–2 to the IRS for the 2012 tax year by April 1, 2013.

[41] A Department of Health and Human Services national database of wage and employment information submitted by Federal agencies and State workforce agencies.

for the Earned Income Tax Credit.[42] The IRS included a request for expanded access to this information in its annual budget submissions for fiscal year 2010 through 2013 and has once again included this request in its fiscal year 2014 budget submission.

One promising development occurred at the end of March 2013, when the IRS announced it was expanding a program designed to help law enforcement obtain tax return data for their investigations and prosecutions of specific cases of identity theft. The IRS initiated this program to assist local law enforcement with arrests and prosecutions related to identity theft. Under a pilot program, which was started in April 2012 in the State of Florida, State and local law enforcement officials who have evidence of identity theft involving fraudulently filed tax returns were able, through a written disclosure consent waiver from the victim, to obtain tax returns filed using the victim's SSN. The pilot was expanded in October 2012 to eight additional States. There was widespread use of this program. Under the pilot, more than 1,560 waiver requests were received by the IRS from more than 100 State and local law enforcement agencies in the nine States participating in the pilot. On March 29, 2013, the pilot was expanded to a permanent program that was effective for all 50 States and the District of Columbia.

Even with improved identification of tax returns that report false wage and withholding information, verifying whether the returns are fraudulent will require resources. Using IRS estimates, it would cost approximately $32 million to screen and verify the approximately 1.5 million tax returns that we identified as not having third-party information, which indicates that the return information could be false.

The IRS is developing a new Return Review Program system to implement its emerging business model for a coordinated approach for prevention, detection, and resolution of pre-refund tax fraud. This system will replace the IRS's current fraud detection system, the Electronic Fraud Detection System, which was implemented in 1994. The Return Review Program system is critical for the IRS's success in dealing with tax schemes, and will evaluate tax returns against the prior 3 years' filing history and other external data sources. The first two phases of implementation for the Return Review Program will occur in the 2014 and 2015 filing seasons.

Regarding assistance to identity theft victims, TIGTA reported that the IRS is not effectively providing assistance to taxpayers who report that they have been victims of identity theft, resulting in increased burden for those victims.[43] Moreover, identity theft cases can take more than 1 year to resolve and communication between the IRS and victims is limited and confusing. Victims are also asked multiple times to substantiate their identities.

In addition, the management information system that telephone assistors use to control and work cases can add to the taxpayer's burden. For instance, the IRS may open multiple cases for the same victim, and multiple assistors may work that same victim's identity theft issue. A review of 17 taxpayers' identity theft cases showed that 58 different cases involving those taxpayers had been opened, and multiple assistors had worked their cases. Our audit also found that victims become further frustrated when they are asked numerous times to prove their identities, even though they have previously followed IRS instructions and sent in Identity Theft Affidavits[44] and copies of their identification with their tax returns. We also found in May 2012[45] that the IRS sends the victims duplicate letters at different times, wasting agency resources and possibly confusing the victims.

The growth of identity theft presents considerable challenges to tax administration. In calendar year 2011, the IRS reported that over 641,000 taxpayers were victims of identity theft. This figure includes taxpayers who contacted the IRS alleging that they were victims. In calendar year 2012, the IRS identified an additional 1.2 million of these taxpayers.

In fiscal year 2012, the IRS dedicated 400 additional employees to the Accounts Management function[46] to work identity theft cases. As a result, the function now has approximately 2,000 employees working these cases. However, its inventory of identity theft cases has grown almost 50 percent from fiscal year 2011 to 2012. As of March 9, 2013, the Accounts Management function reported that it had more than 249,000 identity theft cases in its inventory.

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[42] A tax credit for certain people who work and have earned income under $50,270.

[43] TIGTA, Ref. No. 2012–40–050, *Most Taxpayers Whose Identities Have Been Stolen to Commit Refund Fraud Do Not Receive Quality Customer Service* (May 2012).

[44] IRS Form 14039, *Identity Theft Affidavit.*

[45] TIGTA, Ref. No. 2012–40–050, *Most Taxpayers Whose Identities Have Been Stolen to Commit Refund Fraud Do Not Receive Quality Customer Service* (May 2012).

[46] The function that works the majority of identity theft cases involving individual duplicate tax returns.

Criminal Investigations of Identity Theft

Identity theft not only has a negative impact on the economy, but the damage it causes to its victims can be personally, professionally, and financially devastating. When individuals steal identities and file false tax returns to obtain fraudulent refunds before the legitimate taxpayers file, the crime is simple tax fraud, which falls within the programmatic responsibility of IRS Criminal Investigation. TIGTA's Office of Investigations focuses its resources on investigating identity theft that has any type of IRS employee involvement, the misuse of client information by tax preparers, or the impersonation of the IRS through phishing[47] schemes and other means.

For example, a former IRS employee was arrested after being charged by a Federal grand jury on June 26, 2012, for aggravated identity theft, mail fraud, unauthorized inspection of tax returns and return information, and unauthorized disclosure of tax returns and return information. She subsequently pled guilty to those charges on August 14, 2012, and was sentenced on March 28, 2013, to 28 months of imprisonment with 3 years of supervised release.[48]

TIGTA also investigated a tax preparer who stole the personal identifiers of several individuals and unlawfully disclosed the information to others to fraudulently obtain tax refunds. According to the indictment, the subject of the investigation worked as a tax preparer from January 2002 to June 2008. In 2010, he used the personal identifiers of other individuals to file false income tax returns and obtain refunds from the IRS. The preparer obtained most of the personal identifiers in the course of his prior employment as a tax preparer and from other employment positions he held. He disclosed this information to co-conspirators so they could also file false income tax returns and obtain refunds from the IRS. The subject and his co-conspirators ultimately defrauded or attempted to defraud the IRS out of at least $560,000 in tax refunds.[49]

As a third example, TIGTA investigated a phishing scheme in which several individuals were deceived into divulging their personal identifiers and banking information to identity thieves who then defrauded them of more than $1 million. The subject and his co-conspirators operated a scheme to defraud numerous individuals through Internet solicitations and stealing the identities of those individuals. The subject of the investigation was sentenced to a total of 30 months of imprisonment and 5 years of supervised release for aggravated identity theft and conspiracy to commit wire fraud. He was also ordered to pay $1,741,822 in restitution to his victims.[50]

While phishing schemes may vary in their technical complexity, most share a common trait: They involve computers located outside the United States. Despite the significant investigative challenge this poses, TIGTA has been successful in working with law enforcement personnel in foreign countries to identify the perpetrators and obtain prosecutions.

Identity thieves may also commit identity theft by impersonating IRS employees or misusing the IRS seal to induce unsuspecting taxpayers to disclose their personal identifiers and financial information. One such criminal posed as an IRS "Audit Group Representative" and, according to the indictment, sent letters to various employers demanding that they send him the names, contact information, dates of birth, and SSNs of their employees. He then prepared and filed false Federal tax returns in the names of the employees without their knowledge or consent. The tax returns contained W–2[51] information, such as income and withholding, that was falsely and fraudulently inflated. The subject of the investigation used the refunds to purchase personal items. The subject pled guilty to false impersonation of an officer and employee of the United States; identity theft; subscribing to false and fraudulent U.S. individual income tax returns; and false, fictitious, or fraudulent claims. He was sentenced to 41 months of imprisonment and 3 years of supervised release. He was also ordered to pay $8,716 in restitution.[52]

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[47] Phishing is an attempt by an individual or group to solicit personal and financial information from unsuspecting users in an electronic communication by masquerading as trustworthy entities such as government agencies, popular social Web sites, auction sites, online payment processors, or information technology administrators.

[48] E.D. Pa. Arrest Warrant executed July 5, 2012; E.D. Pa. Crim. Indict. filed June 26, 2012; E.D. Pa. Crim. Docket dated Jan. 22, 2013.

[49] S.D. Cal. Superseding Indict. filed June 19, 2012.

[50] E.D.N.Y. Response to Defendant's Sentencing Letter filed Dec. 19, 2011; E.D.N.Y. Judgment filed Aug. 9, 2012.

[51] Form W–2, *Wage and Tax Statement.*

[52] S.D.N.Y. Crim. Indict. filed Jan. 25, 2012; S.D.N.Y. Minute Entry filed July 11, 2012; S.D.N.Y. Judgment filed March 25, 2013.

Refundable Credits

The IRS administers numerous refundable tax credits.[53] The most significant refundable credit is the Earned Income Tax Credit (EITC). Two other refundable credits include the Additional Child Tax Credit (ACTC) and the American Opportunity Tax Credit (AOTC).[54] For several years, TIGTA has reported significant concerns with the growth in noncompliance and fraud in refundable tax credits.[55]

The EITC remains the largest refundable credit based on the total claims paid, and it continues to be vulnerable to a high rate of noncompliance, including incorrect or erroneous claims caused by taxpayer error or resulting from fraud. TIGTA continues to report that the IRS does not have effective processes to ensure that claimants qualify for these credits at the time tax returns are processed and prior to issuance of fraudulent tax refunds. The IRS estimates that it has paid between $110 billion and $133 billion in improper EITC payments from fiscal years 2003 through 2012.[56] It does not track estimates for the other refundable credits.[57]

The IRS has made little improvement in reducing EITC improper payments in the years since it was required to report estimates of these payments to the Congress in calendar year 2002. The rate of improper EITC payments has remained high and there continues to be a risk that no significant improvement will be made in reducing EITC improper payments. The IRS estimates that the EITC improper payment rate was 21–25 percent in fiscal year 2012, which equates to $12 billion to $14 billion.

TIGTA further reported that although Executive Order 13520[58] requires the IRS to intensify its efforts to reduce EITC improper payments, reduction targets and strategies have not been established to reduce the billions of dollars associated with these payments.[59] For example, the Executive order requires the IRS to provide TIGTA with its plans and supporting analysis for meeting those targets. The IRS's report to TIGTA did not include any quantifiable targets to reduce EITC improper payments. IRS management noted that it did not set reduction targets because it must balance enforcement efforts among different taxpayer income levels.

The Additional Child Tax Credit is also susceptible to improper claims. However, the IRS did not identify the ACTC as a high-risk program under the Improper Payments Elimination and Recovery Act of 2010 (IPERA).[60] Agencies are not required to take any further action to assess or quantify improper payments if a high risk for improper payments does not exist. As a result, the IRS and the Department of the Treasury are not required to quantify and report on ACTC improper payments. Nevertheless, TIGTA found that taxpayers repeatedly claimed erroneous ACTCs after their claims were disallowed the previous year.[61] The IRS could have saved more than $108 million by reviewing claims made by taxpayers who were previously disallowed the credit. TIGTA has reported that the IRS's risk process does not provide a reliable assessment of the risk of improper payments in the IRS's revenue program funds.[62] In addition, TIGTA found that the IRS is not in compliance with all IPERA requirements reported to the Department of the Treasury.[63]

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[53] A refundable tax credit is a tax credit that is treated as a payment and can be refunded to the taxpayer. Refundable credits can create a Federal tax refund that is larger than the amount a person actually paid in taxes during the year.

[54] Other refundable credits claimed by a small number of taxpayers include the Health Coverage Tax Credit, the Fuel Tax Credit, and the Credit for Prior Year Minimum Tax.

[55] TIGTA, Ref. No. 2012–40–105, *Expansion of Controls Over Refundable Credits Could Help Reduce the Billions of Dollars of Improperly Paid Claims* (Sep. 2012).

[56] Department of the Treasury Performance and Accountability Reports for fiscal years 2003 through 2010 and the Agency Financial Report for fiscal years 2011 and 2012, as outlined in Office of Management and Budget Circular No. A–136.

[57] TIGTA, Ref. No. 2013–40–024, *The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for fiscal year 2012* (Feb. 2013).

[58] *Reducing Improper Payments and Eliminating Waste in Federal Programs,* November 23, 2009.

[59] TIGTA, Ref. No. 2011–40–023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year* (Feb. 2011).

[60] Public Law 111–204, 124 Stat. 2224. 2010.

[61] TIGTA, Ref. No. 2012–40–105, *Expansion of Controls Over Refundable Credits Could Help Reduce the Billions of Dollars of Improperly Paid Claims* (Sep. 2012).

[62] TIGTA, Ref. No. 2013–40–015, *Improper Payments Elimination and Recovery Act Risk Assessments of Revenue Programs are Unreliable* (Jan. 2013).

[63] TIGTA, Ref. No. 2013–40–024, *The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012* (Feb. 2013).

TIGTA also found that when the IRS freezes and reviews a questionable EITC claim but releases a related ACTC, the ACTC will later be disallowed 67 percent of the time, and the IRS will have to employ post-refund collection methods to recover the credits. Erroneous credits discovered after refunds are released may require more costly enforcement actions, and the likelihood of collection diminishes over time. The IRS could have prevented approximately $419 million in erroneous ACTC refunds from being released had it reviewed the ACTC at the same time the EITC was being reviewed.

In September 2011, we reported that as of May 28, 2010, 2.1 million taxpayers received $3.2 billion in education credits such as the AOTC that appeared to be erroneous.[64] Another TIGTA audit found that individuals were claiming education tax credits for students who, based on age, are unlikely to be pursuing an undergraduate degree or vocational certification.[65]

We notified the IRS on January 5, 2012 that we had identified approximately 35,000 individuals who were younger than the typical age of individuals enrolled in a 4-year college degree program or vocational school certificate program who were claimed for the AOTC. It appeared that the individuals were used to erroneously claim the AOTC on TY 2009 returns. Of the 35,000 individuals, 13,870 were age 10 and younger. TIGTA's additional review identified more than 109,000 taxpayers who as of May 2, 2012, received refundable AOTC for TY 2011 totaling more than $159 million for students whose age made them unlikely to be enrolled in a 4-year college degree program or vocational certification.

TAXPAYER SERVICE

As demand for taxpayer services continues to increase, resources have decreased, thereby affecting the quality of customer service that the IRS is able to provide. Despite other available options, most taxpayers continue to use the telephone as the primary method to make contact with the IRS. In addition, more taxpayers are calling the IRS's toll-free telephone lines each year. In September 2012, TIGTA reported that an increase in call demand and limited resources continue to adversely affect the IRS's Level of Service for its toll-free telephone lines.[66] During the 2012 Filing Season, taxpayers made over 90 million attempts to call the various Customer Account Services function toll-free telephone assistance lines[67] seeking help in understanding the tax law and meeting their tax obligations.[68] IRS assistors answered more than 13 million calls and achieved approximately a 68 percent Level of Service and a 946-second (almost 16 minutes) Average Speed of Answer.[69]

A reduction in funding for toll-free telephone and correspondence services resulted in a Level of Service for fiscal year 2012 of 67 percent. The IRS plans to provide a 70 percent Level of Service for the 2013 Filing Season as well as for fiscal year 2013. As of March 9, 2013, approximately 56.5 million taxpayers contacted the IRS by calling the various customer service toll-free telephone assistance lines seeking help in understanding the tax law and meeting their tax obligations. IRS assistors have answered 8.3 million calls and have achieved a 67.8 percent Level of Service with a 14.2 minute Average Speed of Answer. This decrease in the Level of Service translates to longer customer wait times, an increased number of customers abandoning calls, and an increased number of customers redialing the IRS toll-free telephone lines for service. The last year the IRS provided a Level of Service of more than 80 percent was fiscal year 2007.

From the 2007 to the 2012 Filing Season, the IRS's ability to process taxpayer correspondence in a timely manner also declined. Assistors who answer the toll-free telephone lines also handle taxpayer correspondence (including processing amended tax returns and identity theft cases). During the filing season when call demand is usually at its highest, more resources are shifted to the telephones to answer calls, and correspondence inventory processing is placed on hold until call demand sub-

[64] TIGTA, Ref. No. 2011–41–083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sep. 2011).

[65] TIGTA, Ref. No. 2012–40–119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sep. 2012).

[66] TIGTA, Ref. No. 2012–40–119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sep. 2012).

[67] The IRS refers to the suite of 29 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

[68] Toll-free telephone assistance data were taken from available IRS reports through the week ending April 21, 2012.

[69] The average amount of time for an assistor to answer the call after the call is routed to a call center staff.

sides. As call volumes have increased and assistors have been moved to answer telephone calls, paper correspondence inventories have substantially increased. The correspondence inventory rose from approximately 480,000 at the end of fiscal year 2007 to more than 1 million at the end of fiscal year 2012, representing an increase of nearly 114 percent.

Each year, many taxpayers also seek assistance from one of the IRS's 397 walk in offices, called Taxpayer Assistance Centers. The IRS assisted almost 7 million taxpayers in fiscal year 2012 and plans to assist 6 million taxpayers during fiscal year 2013, 15 percent fewer than in fiscal year 2012. The fiscal year 2013 plan was based on the assumption of limited seasonal staff support and continuing reduction of permanent staff as a result of the hiring freeze.

As a result, during the 2013 Filing Season, the IRS again provided tax return preparation on a limited number of days per week and only on a first-come, first-served basis. The IRS will not offer taxpayers the option to leave a message when they call local Taxpayer Assistance Center telephone lines. Appointments will not be available. Instead, the IRS offers alternative services for tax return preparation, such as Volunteer Income Tax Assistance, Free File, and Fillable Forms. The IRS has indicated that service provided to taxpayers and the amount of money collected through enforcement activities could decline as a result of the budget cuts of the last few years.

HUMAN CAPITAL

Continued focus by IRS executive management on human capital will remain important because the IRS is facing several key challenges. In addition to a workforce that shrunk by approximately 10,000 employees between the end of fiscal year 2010 and the end of fiscal year 2012, IRS data show that more than one-third of all executives and almost 20 percent of nonexecutive managers are currently eligible for retirement. In addition, the IRS reported FTEs were further reduced in fiscal year 2013. Within 5 fiscal years, nearly 70 percent of all IRS executives and nearly one-half of the IRS's nonexecutive managers are projected to be eligible for retirement. Overall, about 40 percent of the IRS's employees will be retirement eligible within 5 fiscal years.

In the current budget environment, the IRS will also be challenged to continue some of the human capital work it has started. For example, the IRS is undergoing a change in top leadership. Commissioner Douglas Shulman left the IRS when his term expired in November 2012. During Commissioner Shulman's term, he formed the Workforce of Tomorrow Task Force to address the IRS's most serious workforce issues, and much progress was made on human capital issues during his tenure. Interim leadership and the next Commissioner will need to ensure that actions are taken to build on the momentum gained during Commissioner Shulman's term and to effectively address human capital challenges.

TIGTA BUDGET REQUEST FOR FISCAL YEAR 2014

As requested by the subcommittee, I will now provide information on our budget request for fiscal year 2014.

TIGTA's fiscal year 2014 President's budget request is $149,538,000, a decrease of 1.42 percent below the fiscal year 2012 enacted budget. These reductions were a result of savings TIGTA achieved by increasing efficiency, streamlining operations, and reducing costs such as travel, training, communications/utilities, and operations/maintenance of equipment, as well as a hiring freeze for the remainder of the fiscal year and do not include the sequestration reductions. While these budget cuts impact existing programs and reflect the tough choices that the Nation continues to face, TIGTA will continue to focus on its mission of ensuring an effective and efficient tax administration system in this lean budget environment. The fiscal year 2014 budget resources include funding to support TIGTA's critical audit, investigative, and inspection and evaluation priorities, while still maintaining a culture that continually seeks to identify opportunities to achieve efficiencies and cost savings. During the period April 1, 2012 through March 31, 2013, TIGTA's combined audit and investigative efforts have recovered, protected, and identified [70] monetary bene-

[70] Dollars potentially compromised by bribery; dollar amount of tax liability for taxpayers who threaten and/or assault IRS employees; dollar value of IRS and resources protected against malicious loss; dollar amount of embezzlement or taxpayer remittance theft; dollar value of Government property recovered; dollar value of court ordered criminal and civil penalties, fines, and restitution; and dollar value of seizures, forfeitures, and recoveries from contract fraud.

fits totaling $23.6 billion, including cost savings, increased revenue, revenue protection,[71] and court-ordered settlements in criminal investigations.

TIGTA's fiscal year 2014 budget request proposes eliminating certain reviews required by the IRS Restructuring and Reform Act of 1998,[72] which add little value to mission achievement. Eliminating these statutory reporting requirements will allow TIGTA to reinvest resources to conduct higher priority audits.

IRS Implementation of the ACA

Several key ACA provisions will become effective in fiscal year 2014, therefore making fiscal year 2014 a significant year for ACA oversight. Many provisions that previously became effective will require continued oversight to ensure that appropriate corrective actions are taken by the IRS. TIGTA's oversight requires close coordination among the Audit, Investigations, and Inspections and Evaluations functions. Each program office brings unique skills and experience, but TIGTA's overall success depends greatly upon these offices' close collaboration. As such, TIGTA has implemented a multi-year oversight strategy that includes audits, evaluations, and investigative resources to assess and to proactively deter efforts to impede the IRS's implementation of the ACA. This strategy includes coordination with other agencies, including the Department of Health and Human Services Office of Inspector General.

For example, in fiscal year 2013, TIGTA is planning to conduct or initiate 14 ACA-related audits with at least 10 new audits planned for fiscal year 2014. This extensive ACA coverage is stretching TIGTA's Audit resources, especially in light of other audit priorities including requests from the Congress, Treasury, and the IRS and TIGTA's hiring freeze. For TIGTA's investigators, our experience has shown that the IRS's expanded role under the ACA may spark a new wave of animosity directed toward IRS employees. For example, TIGTA has investigated threats made by taxpayers to IRS employees as a result of the IRS offsetting their Federal tax refunds for the repayment of student loans or court-ordered child support payments. TIGTA foresees an increase in the number of threats against IRS employees and facilities as ACA provisions start to take effect, requiring additional resources to be dedicated to investigating these threats.

Shortly after the Supreme Court upheld the constitutionality of the ACA, the media reported that criminals impersonated a Federal agency in an attempt to fraudulently obtain personally identifiable information from unsuspecting taxpayers to further their identity theft schemes and other crimes under the guise that the sensitive information was required for ACA compliance. Based upon our experience investigating this type of criminal activity, TIGTA anticipates a significant increase in the number of ACA-related impersonation attempts as the IRS begins its role in ACA compliance activity.

TIGTA's Audit Priorities

TIGTA's audit priorities include mitigating risks associated with modernization, security over taxpayer data and employees, procurement fraud, addressing the Tax Gap, implementing major tax law changes, and human capital challenges facing the IRS. Recent audit work has uncovered inefficient use of resources at the IRS concerning aircard and BlackBerry® smartphone assignments, shortcomings in the IRS's compliance with the Improper Payments Elimination and Recovery Act, and imperfections in the way the IRS refers and recognizes indications of fraud. In addition, TIGTA has determined that the IRS could develop or improve processes that will increase its ability to detect and prevent the issuance of fraudulent tax refunds resulting from identity theft.

TIGTA's Investigative Priorities

Over the past several years, in order to be responsive to mission requirements, the Office of Investigations has identified efficiencies and embarked on numerous reorganizations to properly place its assets in a position to address the growing number of threats. Consequently, any future budget reductions for OI will be absorbed primarily through law enforcement staffing. This reduction will also severely hamper OI's ability to effectively investigate its other primary program area, investigating allegations of IRS employee misconduct and wrongdoing. OI will be forced to reduce the number of these investigations that are critical to ensuring the IRS and its employees operate with the utmost integrity, free from internal corruption.

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[71] Recommendations made by TIGTA to prevent erroneous refunds or efforts to defraud the tax system.

[72] Public Law No. 105–206, 112 Stat. 685. 1998 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

Procurement Fraud

TIGTA's Procurement Fraud group investigates allegations of waste, fraud, and abuse involving IRS procurements and procurement-related misconduct by IRS employees. The Procurement Fraud group is also responsible for promoting fraud awareness within the IRS contracting community. On average, the IRS executes approximately 900 procurements each year worth approximately $31 billion in total contract value.[73] Due to budgetary pressures, the Procurement Fraud group is currently operating at a reduced staffing level. Consequently, TIGTA does not have the investigative resources to proactively identify and address procurement fraud risks in IRS programs. If the Procurement Fraud group was fully staffed, TIGTA could help ensure that the IRS and taxpayers receive full value for the billions of contracting dollars spent. For example, based on its limited staffing, from May 1, 2009 through September 30, 2012, the Procurement Fraud group initiated 44 investigations, resulting in the recovery of more than $112 million. If properly staffed, the number of investigations and the resulting recoveries would increase substantially. A 2012 Association of Certified Fraud Examiners report[74] estimated that 5 percent of an organization's revenue is at risk of fraud annually. In the case of the IRS, this estimate is $1.6 billion.

Combating Phishing Schemes

Criminals involved in identity theft schemes use creative ways to obtain victims' personally identifiable information[75] to commit fraud. Over the past several years, TIGTA has observed an increase in phishing attacks that use the IRS as a lure—from 3,000 phishing sites in 2008 to more than 13,000 sites so far this year. Much of the activity is hosted from foreign countries. Phishing,[76] which usually involves mass solicitation of potential victims through e-mail or other forms of electronic communication, is a widespread method used by criminals to steal another's identity. TIGTA investigators work with IRS personnel to identify and block these phishing sites and have been successful in working with law enforcement personnel in foreign countries to identify the perpetrators and obtain prosecutions.

Criminals often send e-mails claiming to be from the IRS. These phishing e-mails contain a "hook" that induces the victim to take some sort of overt action. The criminals may lead the victims to believe they are due a tax refund from the IRS or they have won the lottery but must first pay a "tax" before they can receive the money. The victims are instructed to provide their personally identifiable information and financial information such as bank account numbers or credit card numbers to the criminals before the refund or lottery winnings can be released.

Some phishing schemes are designed to install malicious code, or "malware", on a victim's computer. The malware is installed when the victim opens an attachment to the phishing e-mail or clicks on a hyperlink in the e-mail. Once installed, the malware can steal information from the victim-computers or use the victim-computers as part of a network of compromised computers which are then used to perpetrate criminal activity.

In addition, TIGTA OI is also implementing two new enforcement initiatives to address critical tax administration issues:

TIGTA is responsible for protecting the integrity of Federal tax administration and the IRS's most valuable asset: Its employees. Over the past several years, our country has experienced numerous violent incidents in schools, private offices, and public areas. These tragic events are usually unpredictable and result in numerous innocent people losing their lives or being severely injured. Between fiscal year 2009 and 2012, TIGTA has processed more than 8,600 threat-related complaints and conducted more than 4,000 investigations of threats made against IRS employees. To address the potential danger that one of these active threat incidents would be focused on IRS employees (such as the taxpayer who attempted to commit suicide inside an IRS office in 2007), TIGTA special agents are being trained to respond to and neutralize an active threat which could endanger the lives of the approximately 99,300 IRS employees who are employed in more than 670 facilities nationwide.

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[73] The total dollar value of a contract over the life of the contract.

[74] Association of Certified Fraud Examiners, "Report to the Nations on Occupational Fraud and Abuse," 2012.

[75] Personally identifiable information (PII) refers to information that can be used to distinguish or trace an individual's identity, alone or when combined with other personal or identifying information. Examples of PII include: Name, Social Security Number, biometric records, date of birth, financial or bank account information, and driver's license number.

[76] Phishing is an attempt by an individual or group to solicit personal and financial information from unsuspecting users in an electronic communication by masquerading as trustworthy entities such as government agencies, popular social Web sites, auction sites, online payment processors, or information technology administrators.

A large portion of IRS employees are in direct contact with taxpayers and often encounter situations where a taxpayer may challenge the employee's integrity. Bribery, or attempted bribery, of a public official is a serious offense and it is an attack on the integrity of the entire IRS organization. Our voluntary tax compliance system is only successful if taxpayers have confidence that everyone pays their fair share and individuals who attempt to bribe their way out of paying their taxes will be caught and prosecuted. To appropriately respond to this serious crime, TIGTA created a training program for both IRS employees and TIGTA special agents. The purpose of this critical training is two-fold: (1) to raise awareness of bribery overtures to IRS employees and (2) to provide TIGTA special agents with refresher training for conducting bribery investigations. By raising awareness, TIGTA hopes that IRS employees will recognize bribery attempts and promptly report such attempts to TIGTA for investigation.

In this challenging budget environment, we at TIGTA remain committed to delivering our mission of ensuring an effective and efficient tax administration system and preventing, detecting, and deterring waste, fraud, and abuse. We will also identify additional opportunities for cost savings, increased revenue, and revenue protection throughout the IRS. However, with lower budgets, our investigations and audits will be reduced which will result in increased risks of IRS employee integrity lapses, undetected procurement fraud, and the reduced ability to respond to phishing schemes. It will also result in lower identified cost savings and funds put to better use because of fewer audit recommendations to improve control weaknesses and reduced financial recoveries due to fewer successful investigations and prosecutions. TIGTA will be challenged to provide comprehensive coverage to address emerging risks facing the IRS.

I hope my discussion of the IRS budget request and some of the major challenges facing the IRS assists Congress in ensuring accountability over the IRS.

Chairman Lautenberg, Ranking Member Johanns, and members of the subcommittee, thank you for the opportunity to share my views.

Senator MIKULSKI. Thank you very much. We're glad we invited you. That was a very content-rich presentation.

Mr. GEORGE. Thank you.

Senator MIKULSKI. Again, Senator Johanns, sensitive to your time, I'll turn to you, then myself, and then Senator Udall.

Senator JOHANNS. Thank you.

Gentlemen, thank you for being here. Mr. George, having worked with an inspector general when I was Secretary of Agriculture, I have great respect for what you folks do. I can't always say that I enjoyed the meetings with the inspector general, but, you know, the oversight was very positive, and it challenges departments to be better.

AFFORDABLE CARE ACT

If I could focus a few questions on the ACA. I would suspect either one of you would be capable of answering this. At the first of the year there is of course a mandate that goes in place. Under ACA, basically we say thou shalt have this or if you don't you get penalized.

The Supreme Court has weighed in, upheld the validity, said this is a tax. I guess that means the IRS is now involved. So let's say you have thousands, maybe millions, of people out there that aren't complying with ACA, taxpayers. I'm assuming, Inspector General or Mr. Commissioner, that the normal rules of collecting a tax apply. Is that a safe assumption?

Mr. MILLER. I'll start, Senator. Actually, under ACA, if we're talking about the individual shared responsibility payment, which is the—in the first year it's a $95 tax—the normal rules don't apply. The collection rules are different and a lighter touch is required of the Internal Revenue Service with respect to 5000A, the individual mandate, as you called it.

Senator JOHANNS. Could you withhold a—Commissioner, you had something you wanted to offer?

Mr. GEORGE. I was just going to say, Senator, I agree with what Mr. Miller stated, but I think you were alluding to this. It would be in the ability of the IRS to withhold a refund from the non-compliant taxpayer, and that's the way they would enforce the "penalty."

Senator JOHANNS. Right. I'm not suggesting, Commissioner, you'll go put liens against houses and start selling houses across America. But if you owe the IRS money, one of the ways you have of collecting that is, if you're on the positive side in terms of your refund for the next year, that can be seized, in effect, and applied to the penalty.

Commissioner, my assumption is you would have every intention of doing that to taxpayers. They owe the money, you hold the refund.

Mr. MILLER. I think that the offset rules do apply. Precisely what we do in the first year will be a topic of some discussion, because I'm quite sure there will be some confusion, and we'll have to take a good hard look at exactly how we do that.

We're really talking about filing season 2015 in terms of that decisionmaking.

Senator JOHANNS. There's always a day of reckoning with the IRS, though, isn't there? There will be a day where you'll collect whatever penalty is owed. If they have a refund, you'll take it.

Mr. MILLER. I would assume, like any other provision of law, we will enforce the law, yes, Senator.

Senator JOHANNS. In terms of the law itself, a very complicated piece of legislation. The regulations, you've seen the pictures of the 7-foot-high stack of regulations that have been promulgated by different folks implementing this law. In terms of the IRS role, it seems to me that, willing or unwilling, you're a major player in how this law works. You've got to determine a whole bunch of things about taxpayers to see if they qualify for the premium assistance. You've got to determine do they have the appropriate policy, should they be penalized. You've got businesses out there that maybe choose not to provide insurance that should be providing insurance. They've got to be penalized.

It just kind of goes on and on, and I'm not even mentioning half of it. Do your systems today have the information in place where on whatever effective date you're dealing with you hit the switch, boom, you're ready to go? You can say, Mike Johanns, you qualify for premium assistance?

Mr. MILLER. I think the answer is more complicated than that, so let me walk through it a little bit if I could, Senator. Divide the world into two pieces. The first piece of the world begins in October of this year when the health exchanges open up. The health exchanges are State and Federal partnerships. HHS is the face of healthcare with respect to the exchanges for the Federal Government.

Our job, with respect to the October timeframe, is to make sure that the information is available to the exchange to make a reasoned decision as to whether that advance premium credit is available or not. We're not really involved in it other than providing information. That piping has been worked on and I believe we will be ready. That's the first piece.

The second piece goes more to your first question, which is are we set up to do the matching in 2015 for the year 2014 when these things first come in play? The answer to that question is we are not yet ready for that. We are working on it. Part of the budget request goes to that, frankly. But we're working that as we speak and I have no doubt we'll be ready. But that question of how we build systems that will receive 1099s that are specific, how we receive information from the exchanges, insurance companies, and employers, that is not completely done yet, and there is no need for it to be. We're years away from that at this point.

Senator JOHANNS. Yes?

Mr. GEORGE. Senator, as you are well aware, there are already aspects of the ACA in effect. This includes a tanning tax and a number of other provisions. The ultimate implementation of this is over the course of a number of years. We have at TIGTA conducted a few reviews of the IRS's progress thus far in implementing the law.

The law will require approximately 50 changes to the tax code, very complicated in many respects. The IRS has a huge responsibility to inform the American taxpayers about—both taxpayers as well as businesses, individuals, or what have you—of the new requirements under the law. Again, thus far our assessment has been that they've done a sufficient job, but it's just the beginning. There's a lot more that needs to be done, and really the bottom line is, with limited resources, whether through sequestration, rescission, what have you, the IRS is going to have to take from Peter to pay Paul. So whether it's enforcement, whether it's customer service, I don't know how they're going to be able to accomplish this huge responsibility. But I'll defer to the Acting Commissioner to respond further.

Senator JOHANNS. I'll wrap up there because I've used up all my time. You know, that's why I like the inspector generals. They're straight shooters. You know, they don't try to color this.

This is a difficult problem that you have and I just can't imagine how you get from point A to point B. I appreciate the candor of your response, I really do. Thank you.

Mr. GEORGE. Thank you, Senator.

Senator JOHANNS. Thank you, Madam Chair.

Senator MIKULSKI. I concur with Senator Johanns. We hear this and it's not colored, it's unvarnished and independent. That's why we so value the inspector general. And it shows the complexity of implementing ACA.

But in order to implement ACA, you can't use the Appropriations Committee or the sequester to derail a policy that has now been passed into law. That's what I'm concerned about. We have now passed ACA. The House has voted 39 times to repeal it, and I would hope as we go through our regular order we don't use the various Appropriations subcommittees to go after ACA by proxy.

IRS RESOURCE NEEDS

So Mr. Miller has a big job and also he's dealt a very complex hand, one of which is the certainty of his appropriations request through the President and also the impact of the sequester on implementing not only that, but other laws.

Now, I want to be clear on the request. As I understand it, the President has requested for the Treasury Department $14.177 billion for the whole Department of the Treasury. Within that, there's a request for IRS and, Mr. Miller, that request is for $12.861 billion, is that correct?

Mr. MILLER. Yes, it is, Madam Chairwoman.

Senator MIKULSKI. Then, however, when we enacted fiscal year 2013 finally on March 27, with incredible bipartisan support, we were able to pass the continuing funding resolution. That was at $11.793 billion, I believe; is that correct?

Mr. MILLER. Yes, ma'am.

Senator MIKULSKI. But you had a sequestration hit of $594 million, and then because you're a big agency another 2 percent. So don't we have across-the-board cuts of $618 million?

Mr. MILLER. That sounds exactly right.

Senator MIKULSKI. Is that what you're living with?

Mr. MILLER. Yes, $620 million sounds right.

Senator MIKULSKI. About $620 million coming out of IRS, with its technological challenges: one, cyber security; the other, technological modernization in order for you to receive data and to do the job we ask you to do.

Then you have personnel. And from what I gather, your personnel is a highly talented one because it requires people with business, accounting, and other pretty technical skills. Am I correct in that?

Mr. MILLER. The vast majority of our folks are very professional in terms of knowing the tax law and dealing with different aspects of it, yes.

Senator MIKULSKI. So it's not only—first of all, the person answering the phone has to know everything about everything, because who knows what they get. And TurboTax is sometimes not as turbo as we'd like it. Then to the people who actually have to do all the back office work.

How is the morale with the sequester? These are people, very talented business sector, and I would think they're highly desirable in the private sector.

Mr. MILLER. I would—I'm quite sure morale is not what any of us would like it to be, as a Federal employee generally, and as an IRS employee that's taking some time off, who will not be getting the promotional opportunities that they might have expected.

But we have an incredibly highly dedicated workforce, and I'd like to think they're dedicated to public service. That's why they're there, as you might mention. So while morale is not what I would like it to be, we're a dedicated batch of folks and we will get the job done.

MANAGEMENT FLEXIBILITY

Senator MIKULSKI. Well, suppose you were given so-called flexibility. Given where you were already cut less than the fiscal year 2008 level, if you had flexibility would that solve your problem?

Mr. MILLER. I'm not quite sure what flexibilities we're talking about, whether it's the integrity cap or—I'm not sure what we're speaking of, Madam Chairwoman.

Senator MIKULSKI. Well, what I'm saying is there's the belief out here that giving management flexibility is a substitute for money. Is management flexibility a substitute for money?

Mr. MILLER. I think management flexibility will help, but it will only go so far. We have trimmed so much in so many areas that I would think, while being clever managers and efficient people will get us part of the way, it won't get us all the way.

Senator MIKULSKI. Well, Mr. Miller, I'm going to get to a couple of other issues. But I do know your employees. I am so honored that IRS is headquartered in Maryland. As I go around Prince George's County, in and out of Wegman's, I don't exactly join the dance party on Friday night, but I'm out there in the community. I meet the IRS employees, and they are apprehensive.

They signed up for a Government career and they really want to learn the tax code, implement that tax code, and go after the fraud. They want to make sure that if you filed a return and you deserve a refund, you get it in a timely way. If you call, they want to make sure it is answered. They want to go after those crooks in prison that are trying to concoct even more complicated tax fraud schemes. And they want to comply with the VA mandate.

So I think this is not about you, sir. This is about us. And I think we need to really come to grips with this issue of ending the sequester. I know we want the banks to have certainty. I'm for that and regulatory certainty. But you know what else I'm for? I'm for our Federal employees having certainty, that if they work hard and they have a job with their Government and they're doing the job and meeting performance standards they should get pay. And where they are going after fraud or they're doing the job they should, we should be shaking their hand and not handing them a pink slip.

Mr. MILLER. Thank you.

Senator MIKULSKI. So I'm pretty firm about this.

PAYROLL SERVICE PROVIDER FRAUD

Now, let me go to standing up for the little guy, small business, and a problem that I've come across in Maryland. I come from a family of small business, sir. My father was a small neighborhood grocer. My grandmother ran a great bakery shop. Now when you go to businesses like that, it could be the home improvement agency, the florist, they often turn to a payroll service provider in order to meet compliance. They're not like a big business. So they give them the money to pay their taxes and they think they're signing up for all rules and regulations to be met and that their taxes would be paid.

Well, we have a company, whose name I will not mention because of ongoing investigations, that just disappeared. And you know what disappeared? They disappeared and the money that these businesses, like DuClaw Brewery and others, paid in, thinking that they had paid their taxes, also disappeared.

What is now happening, sir, is IRS is coming to them for the taxes. So they feel that they're going to double pay, and then they're getting penalties and fees and so on. So let me tell you where I'm heading with this, not to talk about this individual case. So I was pretty jazzed when I heard about this situation, that these really hard-working, profit-thin businesses, a lot of sweat equity for what they get.

So here is my question. IRS has seen these types of problems before. There was one in Silver Spring and so on. Could you tell me what reforms that you would be making at IRS to deal with this type of fraud? I'm working on legislation, but I want to look at prevention and also make sure that these small businesses don't have to double pay. Could you tell me how you see this problem and what you see to correct this problem?

Mr. MILLER. Again, we won't be talking about specific cases because, of course, we can't. But in general, it's a horrible situation. You have people that don't necessarily know that they're being taken advantage of, and you have the tax liability unpaid.

In these cases—and we need to get better at this, there's no question about it. We need to ensure that there's some way that people receive the notices we send out, because, when we do not receive taxes, we will try to contact people.

There are occasions when things happen that the notice doesn't go to the right place, and we need to get better about that. We have——

Senator MIKULSKI. Not better. It's got to be solved. I'm going to be pretty firm about this. They didn't get these notices. They wrote a check to the company who was supposed to send the money to you. Now, that company didn't tell you or gave them the wrong address, so they never got a notice that they were delinquent. There was no flashing yellow light to them.

So it's not better. It has to be pretty near perfect.

Mr. MILLER. Again, we won't be talking about the individual case, but I will agree with you that it is a problem that we need to solve, and we'll work on that with you as well.

Senator MIKULSKI. But what do want to start working on now and what resources would you need? Why hasn't this been dealt with? Is it a lack of resources?

Mr. MILLER. Part of this, Chairwoman Mikulski, hits a little too close to the individual case. I'm more than willing to come up and talk to you about it. There are some of our procedures that need to be——

Senator MIKULSKI. Ten years ago, a Silver Spring company called First Pay stole millions of dollars, and your own Taxpayer Advocate has said this has come up at other times.

Mr. MILLER. It has.

Senator MIKULSKI. So if it's come up at other times, aren't there yellow flashing lights to have dealt with this sooner?

Mr. MILLER. I think all the cases are a little different. So I'm not "sure." I'm not as familiar with that individual case and I don't think I could speak to it in any event. But all the cases are a little bit different.

It does happen. There are times when taxpayers are absolutely unknowingly involved, and there are times when they are more a part of this activity than not. All these things are different. What I will tell you is we will, in these cases, work with the taxpayer to try to relieve as much stress and as much liability as we can. With respect to penalties, that is not difficult. With respect to interest, it's a little more difficult. Frankly, with respect to taxes it's very difficult. So you have to sort of bucket these things in our discussion.

Senator MIKULSKI. Well, right now does the IRS notify taxpayers when a payroll service provider tries to change its client's business address?

Mr. MILLER. I don't believe so, but let me come back to you on that.

[The information follows:]

At this time, the IRS does not have a process to provide dual notification to the taxpayer and to the requestor for any change of address; however, the IRS is in the process of changing that process and is working to implement dual notification beginning January 1, 2015.

Senator MIKULSKI. Would you take a look at that and see if that would constitute a reform?

Mr. MILLER. It's one of the areas that I agree with you we've got to do.

Senator MIKULSKI. Does the IRS notify taxpayers when the payroll service is delinquent?

Mr. MILLER. That one I do not know.

Senator MIKULSKI. And multiple delinquents?

See, these go to systemic reform, not every case is different. I know every case is different, but then we would never have reform. There are patterns and practices.

Number two, in the prosecution of these cases do you ever seek not only payment, but does it seek restitution?

Mr. MILLER. I would—I have to defer to—the criminal side of this would be handled by the Department of Justice (DOJ). I do believe there's some restitution aspects of it, but I'm not familiar enough. I'd have to come back to you on that.

[The information follows:]

As indicated, the Department of Justice handles the criminal prosecution side of these cases; however, we can confirm there are instances in which the court orders the Payroll Service Provider to make restitution to the victims.

Senator MIKULSKI. Does investigation of these cases lie in IRS or does it lie with DOJ?

Mr. MILLER. It's the IRS. The IRS will investigate, make a recommendation to DOJ, and DOJ will prosecute.

Senator MIKULSKI. I see.

Inspector General.

Mr. GEORGE. I don't disagree with most of what Mr. Miller stated. I would just elaborate on the following. We at TIGTA do have some responsibility investigating those types of incidents, especially when it involves third-party preparers. They play such an integral role in the overall system of tax administration, you're exactly right, Madam Chairwoman, that we have to, the IRS, has to get a closer control over impropriety committed by them.

We have done work that has shown, one, that many IRS employees wear multiple hats. So sometimes they're answering phone calls for the average taxpayer about their tax return, and then these same individuals are sometimes assigned to individuals who have been victims of tax fraud. And that system needs a little more clarification, a little more clarity, both for the victim as well as for the IRS itself.

There are just so many aspects of this overall issue that are troubling to us that—one, thank you for raising it. It's again not limited solely to tax preparers, such as the one you averred to earlier in your statement, Senator, but also again to individual taxpayers in terms of there is some complicity, as Mr. Miller alluded to. If people know that they're under investigation for alleged tax impropriety, they will immediately claim——

Senator MIKULSKI. I've got to stick to this point right now. I'd like to come back, Mr. Miller. What troubles me about your answer, sir, is that you're treating this as a cluster of individual cases rather than a nationwide problem. Now, I think we're going to see, we're seeing this differently. I see this as a nationwide problem. I want to acknowledge that most of these payroll agencies are honest people and small to medium-sized business must rely upon them in order to meet all rules and requirements that they could never learn working all by themselves.

But do you see this as a nationwide problem or do you see this as, well, each case is different?

Mr. MILLER. It is a recurring problem. Whether it's a nationwide problem is a different question. I don't know that it recurs frequently enough for me to consider it a nationwide problem. What we would agree with you on, absolutely, is that there are systemic ways to solve it.

Senator MIKULSKI. Well, one, as we move forward, because I know my time is up, that I would really like you to take a look at this and truly identify over the last 5 years how many complaints have you gotten like this, so you actually know what you got. And I invite the IG for any thoughts, analysis, and recommendations that he would have; and then as we work on legislation that would go through the authorizing process, what recommendations for reform that you would have, one of which is when does the taxpayer have to pay again?

So remember, if they can show that they have written you—written that they took every demonstrable step, with every intent to meet their tax obligation, and you come back and want the same amount of money from them, when do they pay? I believe they should pay when the case has been concluded, not during the case. It's another area of doing it.

This whole address thing and notification and so on, I think notification is important. From what I understand from Mr. Miller, there are multiple ways and multiple different sources that could change addresses.

So let's work on reform. But this is something that's been going on for 10 years, acknowledging the good people, but I'm telling you

I've got a real problem. And it's not that I have a problem, but here we are with people who really work hard.

Mr. MILLER. Agreed.

Senator MIKULSKI. And how we can help them.

Senator Udall.

Senator UDALL. Thank you, Madam Chair. That was a very good line of questioning there.

PREVENTING IDENTITY THEFT AND REFUND FRAUD

I very much appreciate having you both here. Mr. Miller, as you note in your comments, the work of the IRS is critically important, though often thankless, to the functioning of our Government. My first question to you is, in your testimony you spoke about identity theft and refund fraud prevention efforts. I know these issues are problems in my State. Examples I've heard range from constituents whose refund is claimed by someone who has stolen their identity, to cases where refunds are sent directly to another account and the filer never sees a penny of it. These problems are prevalent in rural areas, target limited English proficiency speakers and Native American communities.

Can you share more about what the IRS is doing to stop identity theft and refund fraud in these communities?

Mr. MILLER. I think we're doing a much better job, Senator, on identity theft generally, and that would include rural communities as well. We have quite a few new filters to stop a bad return from coming through. We're not where we need to be yet, but at $20 billion and 5 million returns stopped last year, we are so much better than we were.

But we're not done, there's no question about that. In a perfect world, what would happen is the individual, when they file their return, would have to authenticate that they are who they say they are, whether it's through an out-of-wallet set of questions or something like that. That Steve Miller shows that, yes, he knows where he lived in 1995, or something like that. Then the return would come in to us. That, in and of itself, would cut down on a tremendous amount of this work. Then it would go through our filters.

The second piece of this we need to get so much better at is what happens to the second individual who comes in, the real taxpayer often, because that person hits a wall right now and has to file on paper with an affidavit, and then we have to sort through what is often five Steve Millers, not just two but five.

That has sort of buried us, quite frankly, and we're digging our way out. We had a high of, something close to, 400,000 of these cases. We're now well under 200,000 of these cases. So we're getting past it, and we're stopping more up front, which really is where we need to be. And we do need to get the technology to accept the second return, and have them prove who they are at that time, and let it go through. We're starting to do that now in pilot phases.

Senator MIKULSKI. Senator Udall.

Senator UDALL. Please.

Senator MIKULSKI. Sir, I need to excuse myself and I'm going to ask you to take over the hearing, and go as long as you want and as long as Miller and George can take it, and then close it out.

I want to thank both of you for your participation. We're going to need your advice on an ongoing basis for what we really see are some very difficult challenges around protecting people as they try to comply with this.

Senator UDALL. Thank you, Madam Chair.

Mr. GEORGE. Thank you, Madam Chair.

GENERAL WELFARE EXEMPTION AND TRIBAL PAYMENTS

Senator UDALL [presiding]. Commissioner Miller, my next question to you is about an issue that affects Native American communities, the general welfare exception. As you know—the general welfare exemption. As you know, this exemption allows Indian tribal governments, among other local government entities, to provide social benefit programs to promote general welfare without counting as personal income.

There have been some instances where field examiners have not had the proper training and guidance to understand how this provision should be applied in Native American communities. I understand that the IRS is currently accepting comments on proposed guidance, and I'm pleased that you are taking steps to ensure proper application of the exemption.

Can you give us an update on that process?

Mr. MILLER. Sure, Senator. In December 2012 we put out a draft revenue procedure setting out a whole series of safe harbors on the general welfare doctrine, with respect to tribal payments covering housing, covering eldercare, covering a batch of different areas.

We did that after extensive consultation with tribes. And we are now adhering to that, even during its pendency. The time for comments, I think, ends some time in June and we will then consult again with the tribes and see where we are. But I think so far we've heard that it's going rather well. We have a limited number of examinations in the area continuing that are outside of the safe harbors. We've sort of centralized management of those cases. We've ensured our people are trained. I think we're in a much better place than we were, Senator.

Senator UDALL. Thank you.

IRS WORKFORCE

Now, Commissioner Miller, some people may have a different opinion, but I agree with the testimony we've heard here and I think our Federal employees are a real important resource. The IRS has a large, diverse, and technical workforce. Could you share information about IRS employees, their education level, years of service, the value they provide the Federal Government?

Mr. MILLER. I can do that. It probably makes sense for us to follow up with more detailed information.

[The information follows:]

At the end of the last pay period of fiscal year 2012 (September 22, 2012) the Internal Revenue Service (IRS) had 97,942 employees on the rolls in all functions. These 97,942 employees had the following demographic characteristics:

—Average years of government service: 15.92

—Average years of IRS service: 14.95

—Average age: 48.08 years old

—Average years of education: 15.92 (where 16 would be a bachelor's degree).

The IRS does not track or report enforcement revenue collected by employee, but reports on Return on Investment (ROI) based on the annual enforcement revenue collected and annual appropriated budget. For fiscal year 2012, the IRS enforcement revenue collected was $50.2 billion for a ROI of 4.25.

Senator UDALL. Good.

Mr. MILLER. But in general we reflect our community, both in terms of diversity and in terms of age and of years of service. If you look at our years of service, it's fairly flat. It's not really a bell curve, and you would expect some holes. But generally if you look at 0 to 5, 5 to 10, and so on, it's roughly the same percentage of our workforce.

Now, that becomes a little more problematic, and we'll start seeing donut holes where we didn't do hiring over the last couple of years. That's an issue because at some point these people would have moved into management.

But what you'll see is that we are generally reflective of the communities of which we're a part.

Senator UDALL. Thank you very much.

I would ask, Mr. George, if any of the subjects that I covered with the Commissioner, do you have any comments on those?

Mr. GEORGE. Briefly, yes, Senator.

Senator UDALL. Please.

Mr. GEORGE. As it relates to the ID fraud issue, it is very complicated. It is somewhat perverse in ways because it's who files first who really takes and gets advantage in the overall situation. So if a thief, for lack of a better word, files a false tax return, he or she has the advantage both in terms of the IRS processing that return, paying whatever refund the thief alleges is owed to him or her. But the added complication is the address that the thief gives is put into the IRS's system and that is the way that the IRS communicates with the alleged taxperson as opposed to the actual taxpayer who subsequently files a legitimate tax return and then encounters this—I won't say this maze, but a very unusual system.

The IRS is, again, making progress, as Acting Commissioner Miller pointed out, but it is still extraordinarily frustrating, for the reasons I stated before, in that not a single IRS employee is assigned to a case permanently. It's tossed around to various IRS employees. The IRS employees contact the victim repeatedly asking for identification that the victim has already provided, and it's just extraordinarily frustrating.

For the system itself, ultimately the IRS will hopefully resolve it for the legitimate taxpayer, but then to collect the money from the fraudster is so problematic that—I'll defer to Mr. Miller as it relates to that, whether they actually go after them. You know, I'm not going to reveal any information here that might encourage that type of behavior.

But it's an extraordinarily frustrating system. Something definitely needs to be done. It's an extremely fast-growing problem. It's not only domestic. It's international in nature. And with the advent, obviously, of all the electronic communications that occurs, technology that is used, this is a major problem that the IRS is going to have to address, sir.

Mr. MILLER. Let me if I could, Senator.

Senator MIKULSKI. Mr. Miller, could you please, if you want to say a few words on that.

Mr. MILLER. Just on that one. I think the IG's caricature is an interesting characterization of the system. I think that may be a reflection of the past and not the present. I'd be happy to supply more information for the record that will clarify our processes.

Senator UDALL. We would very much appreciate it.

[The information follows:]

In October 2012, the Internal Revenue Service (IRS) established several identity theft specialized groups to assist with processing identity theft cases. The mission of these groups is to handle identity theft cases efficiently and with consistency. These groups provide a single point of contact based on origin of the problem thus eliminating the need for victims to interact with multiple units. For victims who have multiple issues crossing functions, they will continue to be monitored by the Identity Protection Specialized Unit (IPSU) and be given the IPSU telephone number as their single point of contact for the IRS. This process allows improved tracking and decreases the need for referrals among business units. In identity theft situations, employees work with each victim to resolve their particular situation. Identity theft cases are becoming increasingly complex, involving a manual authentication and review process to ensure we resolve cases satisfactorily for the victim. More than 3,000 employees now work identity theft issues, which is more than double the staffing resources dedicated to working identity theft cases in the previous filing season.

ADDITIONAL COMMITTEE QUESTIONS

Senator UDALL. I thank you both today. If there are no further questions this afternoon, Senators may submit additional questions for the subcommittee's official hearing record by the close of business on Friday, May 10. We request Treasury, IRS, and TIGTA's responses within 30 days. I understand that this subcommittee has been frustrated in the past with unacceptable delay in the receipt of responses from the Treasury Department. I urge that the responses be submitted in a timely manner this year.

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

QUESTIONS SUBMITTED TO HON. JACOB J. LEW

QUESTIONS SUBMITTED BY SENATOR FRANK R. LAUTENBERG

CUTS IMPACTING ANTI-MONEY LAUNDERING/TERRORIST FINANCING EFFORTS

Question. Recent action by the Financial Crimes Enforcement Network (FinCEN) effectively cut off from the international financial system two entities funneling money to Hezbollah. This was a complex web of illicit activity—two Lebanese exchange houses were illegally merging cocaine profits with profits from seemingly legitimate sales of used cars and diverting some of the funds to Hezbollah. This is precisely the type of "connect the dots" tactical work FinCEN uses to follow the trail of criminal networks attempting to exploit our financial system.

Because criminals don't give up, law enforcement must stay the course. The requested 6 percent cut to FinCEN is a concern. While FinCEN just completed a major IT overhaul, the budget doesn't provide funding to hone the new system's capabilities. The budget also envisions cutting eight staff and other generic administrative costs. Further, the Treasury Inspector General cites Treasury's Anti-Money Laundering and Terrorist Financing Enforcement as a continuing Top Management Challenge for the Department.

With a requested budget cut of 6 percent for fiscal year 2014, how will FinCEN continue its robust efforts to combat these kinds of transnational threats to our Nation?

How will Treasury be able to address the challenges cited by the Inspector General if resources for Anti-Money Laundering and Terrorist Financing activities are reduced?

Answer. Combating transnational criminal threats and all other forms of financial crimes is a top priority for Treasury. The Office of Terrorism and Financial Intelligence, which includes FinCEN, will continue to marshal the Department's intelligence and enforcement functions and authorities to safeguard the U.S. financial system from illicit actors that threaten our Nation. While the budget request for FinCEN is lean, the bureau is just one part of the Department's broad, comprehensive effort to address the challenges cited in the Inspector General's management memorandum. We will continue to ensure our anti-money laundering and counter terrorist financing programs and strategies are as effective and vigorous as possible.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTION (CDFI) BOND GUARANTEE PROGRAM

Question. The fiscal year 2014 request would extend the CDFI Bond Guarantee Program, which complements the CDFI grant program by providing $1 billion annually in federally-guaranteed bond financing to CDFIs. The program is estimated to have zero net cost to the taxpayer because loan loss reserves and fees will offset any losses paid by the Federal Government.

What impact will the Bond Guarantee Program have on CDFIs' abilities to invest in and serve distressed communities?

Answer. The availability of long-term financing is one of the major structural issues facing the revitalization of low-income communities. The CDFI Bond Guarantee Program will enable CDFIs to address this need by providing them with a new and affordable source of long-term capital.

Proceeds from guaranteed bonds must be used for eligible community or economic development purposes. Authorized uses of the loans financed may include a variety of financial activities, such as supporting commercial facilities that promote revitalization, community stability, and job creation or retention; community facilities; the provision of basic financial services; housing that is principally affordable to low-income people; businesses that provide jobs for low-income people or are owned by low-income people; and community or economic development in low-income or underserved rural areas.

Question. Will the CDFI Bond Guarantee Program require any appropriations in 2014? If not, how will the Federal Government recoup any losses under the program?

Answer. Consistent with the program's statutory and policy requirements and congressional intent, Treasury does not anticipate needing appropriated funds to cover the cost of the loans under the Bond Guarantee Program. The CDFI Bond Guarantee Program will use various mechanisms, such as the mandatory 3 percent risk-share pool from each eligible CDFI (the borrower) and a liquidity premium on each loan, to mitigate the likelihood of defaults on loans made under each issued Bond, and the borrower collateral requirements will help cover losses should a default arise. Also, the CDFI Fund will review the bond loan for each eligible CDFI made by the qualified issuer, taking into account the eligible CDFI's credit quality and other risk characteristics.

CYBERSECURITY

Question. The Treasury Inspector General (IG) has identified Treasury's cybersecurity efforts as a matter of concern and a potential vulnerability for the Department. Treasury's systems are critical to the core functions of Government and the Nation's financial infrastructure. The IG recommends that Treasury build on existing partnerships among financial institutions, regulators, and private entities in the financial sector so that the Government will be able to identify and respond to emergency cyber threats against financial institutions and the broader financial sector.

How does Treasury's fiscal year 2014 budget request provide adequate budgetary and human resources to properly guard against cyber intrusions?

Answer. Treasury's fiscal year 2014 Budget request includes a 24 x 7 x 365 Government Security Operations Center (GSOC) for Department-wide security event monitoring at our five Internet gateways through which over 95 percent of Treasury's Internet traffic flows. One Bureau is temporarily using a Department of Homeland Security (DHS)-approved gateway at a shared private-sector facility, so over 99 percent of our traffic is monitored in accordance with DHS requirements.

We also provide funding to support the annual review and identification of Treasury's critical infrastructure systems, which provides for the cost-effective prioritization of security resource allocation to the approximately top 5 percent of our more than 400 systems. Our fiscal year 2014 Budget also proposes a new capability to enhance protection of our classified systems through the installation of wireless-intrusion detection and monitoring capability at our two major facilities that contain our classified networks.

Despite tightening budgets, the Department has been able to maintain and enhance our cyber security staffing levels most notably through contractor conversions. We also will be seeking to leverage the DHS's Continuous Diagnostics and Mitigation Program, where appropriate, to maximize the protection of our very sensitive information and availability of services provided by our systems.

Additionally, the Department is working to stand up the Financial Sector Cyber Intelligence Group (FS–CIG) in fiscal year 2013 with the mission of identifying, analyzing, and disseminating timely and actionable cyber threat information to the financial sector.

Question. How is Treasury coordinating and collaborating with the private sector to guard against cyber threats against our financial system?

Answer. Treasury addresses cybersecurity through a network of private and public sector partnerships. Important engagement is being conducted at the level of individual institutions, trade associations, and public-private partnerships. Groups such as the Financial Services Roundtable's BITS division, the Financial Services Sector Coordinating Council for Critical Infrastructure Protection and Homeland Security, L.L.C. (the "Financial Services Sector Coordinating Council (FSSCC)" or "Sector Council" comprised of 60 financial and financial-related institutions and associations), and the operational hub for cyber reporting within the sector the Financial Services Information Sharing and Analysis Center (FS–ISAC) are critical to this engagement. Treasury, participating in the whole of government approach on cybersecurity, is similarly engaged with the public sector through the Financial and Banking Information Infrastructure Committee (FBIIC). The FBIIC, which is chaired by Treasury, includes as members the Financial Stability Oversight Council, the Department of Homeland Security, the Department of Defense, law enforcement agencies, and the intelligence community. Treasury has been one of the most active Government agencies in the Administration's efforts to secure our Nation's digital infrastructure.

Question. Who does Treasury turn to for assistance in creating adequate and appropriate cybersecurity protocols?

Answer. Treasury refers to DHS, National Institutes of Standards and Technology, Defense Information Systems Agency, OMB, Committee on National Security Systems, and Intelligence Community guidance concerning cybersecurity procedures, requirements, and protocols and is an active participant in the Federal Cybersecurity Coordination, Assessment, and Response (C–CAR) protocol for interagency notifications. We work with the various coordination centers, most notably DHS's, during the course of unclassified incidents and through their Joint Agency Cyber Knowledge Exchange group. We also actively communicate with other Federal agencies that have similar activity for lessons learned and best practices. Under our standing procedures, we refer possible criminal activity to the appropriate Inspector General.

Question. How will the administration's February 2013 executive order on cybersecurity help to improve information sharing between Treasury and the private sector on cyber threats?

Answer. The President's Executive Order mentions a number of specific actions which will help to improve information sharing between Treasury and the financial sector. The President has ordered agencies that produce cyber-threat information to do so with greater speed, including at the unclassified level. In addition, DHS is expanding its private-sector clearance program which expedites the processing of security clearances to appropriate personnel employed by critical infrastructure owners and operators. Concurrently, DHS has been tasked to expand the Enhanced Cybersecurity Services program, to share classified cyber-threat and technical information from the U.S. Government to eligible critical infrastructure companies. Taken as a whole, these actions are providing an unprecedented level of Government information sharing that was previously unavailable to the private sector. Treasury is actively promoting and coordinating these programs within the financial sector.

FORECLOSURE RELIEF PROGRAMS

Question. New Jersey ranks second in the Nation after Florida in the percentage of mortgage loans in foreclosure. The New Jersey HomeKeeper Program received $300 million from Treasury's "Hardest Hit Fund" to help New Jerseyans facing foreclosure due to job or income loss. Homeowners are eligible for up to $48,000 through a zero interest loan, and no payments are due for up to 24 months. HomeKeeper is administered by the State of New Jersey, but overseen by Treasury. Unfortunately, the program had only spent 9 percent of its funds by the end of 2012.

What has Treasury done to ensure that the implementation challenges associated with the New Jersey HomeKeeper Program have been resolved? Can you confirm that homeowners in New Jersey are now getting the help they need?

Answer. Treasury shares your commitment to ensuring that all government—Federal and State—foreclosure prevention programs reach eligible homeowners in need of assistance and has made clear to all State housing finance agencies (HFAs) participating in the Hardest Hit Fund (HHF) that it is critical to provide relief to struggling families while the need is still great.

Implementation and management of the State programs under HHF are the responsibility of each HFA. Treasury's job is to facilitate the HFAs' use of the funds. Treasury has worked with the New Jersey HomeKeeper (NJ Housing and Mortgage Finance Agency (HMFA)) staff on improving the performance of the New Jersey HomeKeeper Program by helping to identify operational barriers, share promising and innovative strategies, and work with mortgage servicers and investors to gain wider participation in these programs. NJ HMFA has taken a number of operational and program design actions that have enabled more homeowners to participate in the program. The NJ HMFA staff is also evaluating some new program ideas to pursue in the near future.

NJ HMFA staff estimate that if they assist approximately 250 new homeowners per month, they will fully commit all their funds by December 2014; on average they have consistently met or exceeded this target over the last 6 months. Recent performance updates indicate the program has seen strong growth in homeowner assistance: between September 2012 and March 2013, the number of homeowners assisted in New Jersey has grown by approximately 150 percent. As of May 31, 2013, the program has assisted an estimated 3,330 homeowners with approximately $141 million in committed funds. Actual fund disbursements exceed $64 million.

IRAN SANCTIONS

Question. U.S. companies have been prohibited from doing any business with Iran since a complete trade ban was signed into law in 1995. In August 2012, a new Iran sanctions package was signed into law that included a provision, written by me, closing the loophole that allowed foreign subsidiaries of U.S. companies to continue doing business with Iran without placing the penalties of the U.S. trade ban on the parent companies. A foreign subsidiary of a U.S. company that violates or attempts to violate this provision is now subject to the same penalties as its U.S. parent company would if it were conducting business with Iran, including at least a $250,000 fine per violation. These provisions went into effect in February 2013 after a divestment period. Treasury is responsible for enforcing this law and issuing fines.

If companies are now found to be in violation of this provision, how is Treasury ensuring they will be punished to the maximum extent possible under the law?

Answer. The Office of Foreign Assets Control (OFAC) actively investigates any information about possible sanctions violations across all of its sanctions programs, and takes enforcement action as appropriate. If companies are found to be in violation of Section 218 of the Iran Threat Reduction and Syria Human Rights Act of 2012, OFAC will take appropriate investigative and enforcement action, as it does with all its programs.

ALCOHOL AND TOBACCO TAX EVASION

Question. Treasury's Alcohol and Tobacco Tax and Trade Bureau (TTB) collects Federal excise taxes on alcohol, tobacco, firearms, and ammunition. TTB collects $23 billion annually in excise taxes with a requested budget for fiscal year 2014 of $101.2 million.

TTB also conducts investigations into suspected tobacco tax evasion.

There are drastically different Federal excise tax rates for the many different tobacco products on the market. These differential rates provide tobacco manufacturers with an incentive to manipulate their products in ways that qualify them for lower excise tax rates. For example, the alteration of a product's weight could qualify it for a lower excise tax rate. Is TTB aware of any practices tobacco manufacturers use to attempt to secure lower Federal excise tax rates for their products? If so, please describe these practices.

Answer. Since enactment of the Children's Health Insurance Program Reauthorization Act of 2009 (CHIPRA), TTB has identified and monitored market shifts toward lower-taxed tobacco products by manufacturers, importers, and price-sensitive consumers.

A notable trend is the apparent shift in the volume of small cigars to large cigars. Under the Internal Revenue Code, small cigars are cigars that weigh 3 pounds or less per 1,000, while large cigars are cigars that weigh over 3 pounds per 1,000. Pursuant to CHIPRA, small cigar tax rates increased from $1.828 per thousand to $50.33 per thousand. At the same time, the large cigar tax increased from 20.719 percent of the sale price (not to exceed $48.75 per thousand) to 52.75 percent of the sales price (not to exceed $402.60 per thousand). The ad valorem tax on large cigars can result in lower tax rates on these products, depending on the sale price of the cigar. As a result, since the tax increase in CHIPRA, TTB has found that some manufacturers increased the weight of products so that they meet the statutory definition of a large cigar for tax purposes. The chart below summarizes the market shift from small cigars to large cigars since CHIPRA.

DOMESTIC MANUFACTURED CIGARS—REMOVAL SUMMARY

[Percent of Domestic Cigar Market]

	Pre CHIPRA	Post CHIPRA			
	Period 1—2009	Period 2—2010	Period 3—2011	Period 4—2012	Period 5—2013
Large Cigars Percent Mkt	47	89	92	93	93
Small Cigars Percent Mkt	53	11	8	7	7

A second trend is the shift in pipe tobacco and roll-your-own (RYO) tobacco products. The definitions of these products in the Internal Revenue Code include how they are packaged and labeled for consumers and do not specify distinguishing physical characteristics of the tobacco itself. Prior to CHIPRA, the tax rates on pipe tobacco and RYO tobacco were the same at just under $1.10 per pound. As a result of CHIPRA, the tax on pipe tobacco was increased to just over $2.83 per pound, while the tax on RYO tobacco was increased to $24.78 per pound. This difference in tax rates has resulted in an increase in the volume of pipe tobacco reported as produced by domestic manufacturers, with a corresponding decrease in the amount of RYO tobacco reported as removed. The chart below summarizes the market shift from RYO tobacco to pipe tobacco since CHIPRA.

DOMESTIC PIPE AND RYO TOBACCO—REMOVAL SUMMARY

[Percent of Pipe/RYO Market]

	Pre CHIPRA	Post CHIPRA			
	Period 1—2009	Period 2—2010	Period 3—2011	Period 4—2012	Period 5—2013
Pipe Tobacco Percent Mkt	13	67	82	88	90
RYO Tobacco Percent Mkt	87	33	18	12	10

Question. If a TTB investigation reveals tobacco tax evasion has occurred, what enforcement tools does TTB have to levy penalties on the violating person or entity? Are these enforcement tools effective in halting and preventing further tobacco tax violations? If so, what features contribute to their effectiveness? If not, why not, and what other enforcement tools would be necessary to ensure that TTB's tax enforcement efforts effectively deter further violations?

Answer. Under the Internal Revenue Code, TTB may initiate administrative action to suspend or revoke a permit under 26 U.S.C. § 5713; impose civil penalties under 26 U.S.C. §§ 5761, 6663, and 6701; investigate and refer criminal violations under 26 U.S.C. §§ 5731, 5762, 7201, 7203, 7206, 7207, and 7208; and seize and forfeit property under 26 U.S.C. § 5763.

Permit actions (suspending or revoking a permit) effectively deter tax evasion by the affected permitted industry members, who typically wish to continue operations. The industry-wide deterrent effect of these cases is muted, however, due to limitations on disclosure of tax return information under 26 U.S.C. § 6103, which make publicity surrounding these proceedings limited or non-existent.

Civil penalties are generally effective against permitted industry members, particularly those penalties that are assessable as a tax pursuant to 26 U.S.C. § 6665. Many tobacco excise and related civil penalties are assessable; a notable exception is the $1,000 civil penalty under 26 U.S.C. § 5761(a) for willfully omitting things required or doing things forbidden, which must be recovered in a civil action. Criminal penalties are TTB's most effective tool against non-permitted industry members.

ALCOHOL AND TOBACCO TAX EVASION

Question. The fiscal year 2014 budget request includes $2 million to continue a pilot program allowing TTB to pursue criminal tax evasion. The program not only provides public health benefits by keeping illicit alcohol and tobacco off of the market, but it also helps secure potentially billions in Treasury revenues. It is estimated that evasion of Federal tobacco taxes alone totals about $4.5 billion a year.

How has the pilot program enabled TTB to expand its enforcement efforts for tobacco and alcohol tax evasion?

Answer. Before receiving this funding, TTB did not have direct access to agents to develop and investigate criminal cases for tobacco and alcohol tax evasion. Since fiscal year 2011, the six special agents provided to TTB by IRS on a reimbursable basis have opened 58 criminal investigations that involve a total estimated Federal excise tax liability of nearly $340 million and seizures valued at over $115 million. To date, TTB has presented 53 of these investigations to Assistant United States Attorneys, all of which have been accepted for investigation. Several additional cases pending acceptance for investigation are expected to be presented in the near future.

By operating its own criminal enforcement program, TTB has been able to exercise control over its investigations and use the complementary skill sets of its auditors, investigators, and scientists in developing criminal cases. Through investigating its own cases, TTB is also better able to address all issues in a case, so that remedies such as restitution and surrender of permits can be included in criminal case resolutions where appropriate. In addition, TTB special agents have allowed the bureau to pursue cases and violations that may not have been pursued by other Federal law enforcement agencies that lack primary jurisdiction for those violations, particularly in cases that solely involve Federal excise tax violations.

It should also be noted that the extent of Federal revenue losses due to tobacco diversion is currently unknown due to the inherently clandestine nature of diversion activity and the lack of reliable tobacco consumption data upon which such an evaluation would be based.

Question. What types of cases has TTB pursued? Have there been major convictions?

Answer. TTB agents have been involved in the following types of investigations:

—Diversion of export only cigarettes;
—Illegal manufacturing of cigarettes;
—Illegal manufacturing of hookah tobacco;
—Illegal importation of tobacco products;
—Floor stocks excise tax evasion on cigarettes;
—Filing of false excise tax returns for the production of alcohol;
—Diversion of export only alcohol;
—Misclassification for tax purposes of imported liquor;
—Illegal transportation of alcohol from lower tax States to higher tax States;
—Importation of intentionally mislabeled wine; and
—Illegal manufacturing of spirits.

TTB's accomplishments since fiscal year 2011 include the following:

—Conviction on TTB's first-ever criminal floor stocks tax investigation. Federal excise tax loss was in excess of $275,000.
—Convictions of three subjects and the indictment of two additional individuals in a cigarette excise tax evasion case. Federal excise tax loss was in excess of $37 million.
—Conviction of an individual involved in the sale of untaxed bidis cigarettes. Federal excise tax loss was in excess of $640,000.
—Conviction of an individual for the evasion of alcohol excise tax on manufactured product. Federal excise tax loss was in excess of $870,000.
—Convictions of two individuals involved in the importing of fruit wines intentionally misclassified for Federal excise tax purposes. TTB seized over 11,500 cases of wine. Federal excise tax loss was in excess of $120,000.
—Conviction of an individual for the misclassification of Soju liquor as wine to evade Federal excise taxes. Federal excise tax loss was in excess of $92,000.

The total amount that TTB will actually collect from these cases (as compared to the identified Federal excise tax losses) cannot yet be determined because civil penalties are typically resolved following the resolution of criminal charges. The above convictions are relatively recent, and the civil penalties have not yet been resolved.

Question. How is TTB measuring the outcomes of the pilot program? What outcomes have been shown?

Answer. There are inherent challenges in measuring the outcomes of TTB enforcement activity because assessing the magnitude of illicit activity is difficult given that the goal of perpetrators is to conceal transactions and evade detection. In addition, TTB does not have baseline and trend data for its criminal enforcement program because it is still in its early stages. To date, TTB's evaluation of the outcomes of its program has included the number of cases opened, the value of liabilities identified and property seized, and the acceptance rate of cases referred to Assistant U.S. Attorneys. Since the inception of TTB's criminal enforcement program in fiscal year 2011, TTB has initiated 58 cases with identified Federal tax liabilities of nearly $340 million and seizures valued at more than $115 million, and achieved an acceptance rate of 100 percent for the cases referred to Assistant U.S. Attorneys for investigation. Notably, all of the cases that have been forwarded by TTB for prosecution and which have come to a conclusion in the criminal justice system to date have resulted in convictions, indicating the quality of the cases developed by TTB's criminal enforcement program.

Question. How does TTB's pilot program enhance Federal Government efforts to pursue criminal tax evasion? How do TTB's enforcement efforts differ from those of the Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF) and the Federal Bureau of Investigation (FBI)? How does TTB collaborate with and build upon the tax evasion enforcement efforts of ATF and FBI?

Answer. TTB's enforcement program is focused on detecting and investigating violations in areas where TTB has primary jurisdiction, which include the Federal Alcohol Administration Act and the Internal Revenue Code as it relates to alcohol, tobacco, firearms, and ammunition. By contrast, ATF and FBI's primary jurisdiction and focus do not involve the collection of Federal excise taxes. When TTB conducts joint investigations with other Federal agencies, TTB special agents, investigators, and auditors ensure that criminal tax evasion is pursued and that related remedies, including restitution and surrender of permits, can be included in criminal case resolutions where appropriate.

Question. Are there additional efforts that could be pursued if more than $2 million was available for the pilot program in fiscal year 2014?

Answer. The fiscal year 2014 President's budget proposes a program integrity cap adjustment of $5 million to pursue tax enforcement and compliance efforts that would not be feasible with only $2 million available for the TTB program. The proposal would fund new revenue-producing tax enforcement and compliance initiatives in fiscal year 2014, and continue to provide $5 million annually to TTB for additional enforcement and compliance initiatives from 2015 through 2018. These funds, of which $2 million will be used for special agent support, would support the increased enforcement activities and capabilities that are needed to address tax-evasion schemes relating to alcohol and tobacco diversion. Through these initiatives, TTB would target points in the supply chain that are susceptible to diversion activity and implement forensic audits and investigations of targeted entities in the alcohol and tobacco industries. The fiscal year 2014 President's Budget cap adjustment request of $5 million allows for the hiring of auditors, investigators, and special agents. The total above-base cap adjustment including inflation would be $202 million over the 10-year period. Over this same period, these investments would generate an estimated $406 million in additional tax revenue and a net savings of $204 million.

LIBYA CLAIMS PROGRAM

Question. As you may know, I have long sought justice for victims of state-sponsored terrorism and championed the legislation creating a fund for Libya to compensate U.S. victims of Libyan terrorism. It is my understanding that the Foreign Claims Settlement Commission at the Department of Justice has notified Treasury that it has completed its adjudication of all claims under the Libya I and II claims programs. I also understand that Treasury has only made partial, prorated payments of 20 percent of the unpaid balance that remains on the awards in the Libya claims programs.

What is Treasury's timeline for making the payments on the remaining 80 percent of Libya claims favorably adjudicated by the Foreign Claims Settlement Commission?

Answer. Treasury began mailing notification packages to awardees the week of 6/10/13. The packages contain documents that must be signed by the awardees, notarized (as required), and returned to Treasury. Once signed documents are received from an awardee, Treasury will begin processing payment of the award balance remaining due to that awardee. Treasury's required processing time is typically 2 to 4 weeks from the date that documents are received. Therefore, the actual timeline for Treasury to complete making these final payments is dependent upon the responsiveness and timeliness of awardees in returning their completed documents to Treasury.

Question. What is Treasury's estimate of remaining funds in the Libya settlement fund once these payments are made in full?

Answer. Although the exact amounts will depend on several factors (including the actual timing of all disbursements), Treasury is able to provide the following general information: The Department of State transferred approximately $416.6 million from its Libyan Settlement Fund account to Treasury in connection with its two referrals of claims to the Foreign Claims Settlement Commission. Of this amount, approximately $20.8 million was deposited into Treasury as miscellaneous receipts pursuant to 22 U.S.C. § 1626(b)(2). The balance was deposited into two Treasury accounts established for the payment of Commission awards arising out of the Libya I and II claims programs. The Commission's awards from those two programs total approximately $370.8 million. Therefore, once Treasury has completed paying all Libya I and II Commission awards, just under $25 million will remain of the amounts originally transferred to Treasury by State. Any questions concerning the disbursement of the remaining funds should be directed to the State Department.

INTERNATIONAL SANCTIONS ON IRAN

Question. The European Union has been a valuable partner in creating an international sanctions regime on Iran. Europe's ban on the importation of Iranian oil has led to billions of dollars in lost revenue to Tehran. However, some have raised concerns about the ability of Iran to use the European Central Bank's (ECB) payment system, Target2, to process euro transactions.

Has Treasury found evidence of Iran's ability to evade financial sanctions by conducting transactions involving euros utilizing the ECB's payment system?

Answer. Treasury strongly supports the policy objective of restricting Iran's access to the euro, which we believe is also shared by European policy-makers and regulators. Treasury remains vigilant in watching for evidence that sanctioned Iranian entities are evading U.S. and international sanctions by accessing the international financial system, including through the EU financial system. Additionally, any foreign financial institutions that knowingly facilitate significant transactions or provide significant financial services for entities or individuals sanctioned under our Iran program are exposed to the potential loss of access to the U.S. financial system under the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA).

Question. What steps can the U.S. take to ensure Iran does not have the ability to conduct transactions in euros or other foreign currencies?

Answer. Treasury has engaged with our European partners about further restricting Iran's access to the European financial system and to the euro. As of July 1, pursuant to a new Executive Order, E.O. 13645, any foreign financial institution that knowingly conducts significant transactions related to the sale or purchase of Iranian rials, or holds significant funds or accounts outside Iran denominated in rials, is exposed to U.S. sanctions. This new measure will present a substantial impediment to Iran's efforts to convert rials into desired international currencies.

ANTI-MONEY LAUNDERING

Question. In the last few years, several major financial institutions, including HSBC and Standard Chartered, have been fined hundreds of millions of dollars for conducting transactions with state sponsors of terrorism and for laundering money for drug cartels.

Do you believe that banks, regardless of their size, should be held criminally liable if they knowingly violate U.S. sanctions and money laundering laws? Should the individual bankers responsible for the violations be held accountable?

Answer. The Treasury Department supports vigorous enforcement of the law and believes that no individual or institution is above the law, regardless of size or any other characteristic. Although Treasury does not have statutory authority to impose criminal penalties—that authority rests exclusively with the Department of Justice—Treasury does have the authority to investigate potential violations of U.S. economic sanctions, as well as certain anti-money laundering laws and regulations, and to impose civil penalties. Treasury has a clear record of aggressively pursuing investigations and enforcement actions against both U.S. and foreign financial institutions that violate those laws and regulations.

Question. Can you describe the cooperation between Treasury, the Department of Justice, and other Federal regulators in investigating violations of money laundering and sanctions laws and making decisions as to whether to bring about criminal charges? Are there ways that cooperation and information sharing towards these efforts could be improved?

Answer. The Treasury Department has a number of formal and informal mechanisms to facilitate cooperation with the Federal regulators. Treasury's cooperation primarily involves the Financial Crimes Enforcement Network (FinCEN) for matters involving money laundering violations, and the Office of Foreign Assets Control (OFAC) for matters involving sanctions violations. With regards to cooperation on potential criminal actions, these Treasury points of contact would cooperate with the relevant offices of the Federal regulators and the Department of Justice and share information in order to develop a common understanding of the facts underlying any potential violations being investigated. In addition, the Treasury Department convened an Anti-Money Laundering (AML) Task Force last fall that includes, in addition to Treasury, the Federal banking regulators (Federal Reserve, FDIC, OCC, and the National Credit Union Administration), the IRS, the Commodity Futures Trading Commission, the Securities and Exchange Commission, and the Department of Justice. The Task Force is currently analyzing a number of issues relevant to the United States' AML framework, including improving information sharing among all the agencies.

STATE AND LOCAL TAX DEDUCTION

Question. States like New Jersey that provide their residents comprehensive State and local government services (thereby reducing the burden on the Federal Government's safety net) tend to have higher State and local taxes. Right now, taxpayers who itemize can take a deduction on their Federal tax return for State and local taxes paid. But Treasury has proposed that Congress limit the value of itemized deductions, including the deduction for State and local taxes paid, for certain taxpayers. This is estimated to affect 6.7 percent of New Jersey taxpayers.

Could limiting the ability of taxpayers to deduct State and local taxes paid reduce the willingness of State and local governments to provide services that contribute to the health and welfare of their citizens?

Answer. The administration's proposal only limits the value of the deduction and State and local taxes for higher-income taxpayers; it is not eliminated. The deduction still provides a substantial benefit of up to 28 cents on the dollar. We do not expect this modest reduction in the value of the Federal tax expenditure for the deduction of State and local taxes to have much effect on the level of services provided by State and local governments in New Jersey and other States.

Question. Could a limit on the ability to deduct State and local income taxes on Federal income tax returns encourage States to instead raise revenue through regressive sales taxes instead of more progressive property and income taxes?

Answer. There is no reason to believe that the Administration's proposal will induce a significant move to State and local sales taxes. The Administration's proposal would allow the deduction of income and property taxes (though with a maximum value of 28 percent), while the deduction for sales taxes is scheduled to expire at the end of 2013, thereby maintaining an incentive for New Jersey to use income and property taxes to raise needed revenue.

QUESTIONS SUBMITTED BY SENATOR MIKE JOHANNS

Question. Following up on a discussion we had at the hearing, do I understand correctly that the Treasury Department will not support any legislation to protect non-financial end users until the point in time when the flawed rules are fully implemented and manufactures, agricultural and energy producers, and technology companies suffer?

Answer. The Dodd-Frank Act included critically important reforms to provide regulation of derivatives activity. The issue of end-user margin is very important, but I understand that the regulators are still working on their task in this regard. Once there has been full implementation, I am happy to work with Congress on issues that warrant attention.

Question. I believe it to be beyond debate that the Congressional intent of financial regulatory reform was to protect those end users that utilize the derivatives markets to mitigate legitimate business risk. Do you agree?

Answer. The Federal agencies responsible for implementing Title VII of the Dodd-Frank Act have proceeded in accordance with their interpretations of the statute.

The Commodity Futures Trading Commission (CFTC) and SEC have proposed rules that would not impose margin requirements on non-cleared swaps entered into with a non-financial end-user. Under the proposals, non-bank swap dealers and major swap participants would be required to establish credit support agreements with the non-financial counterparty that cover credit risk terms and conditions.

The prudential banking regulators jointly proposed and reopened rules that would require bank swap dealers and major swap participants to establish credit thresholds above which margin would have to be posted by non-financial end-users. Under guidance currently being developed, non-financial end-users would only have to post margin if their non-cleared swap exposures were more than $50 million. The CFTC, the SEC, and the prudential regulators should be permitted to continue their work through the public comment and rulemaking process.

Question. Chairman Bernanke has repeatedly indicated that the Federal Reserve would like to have the flexibility to not mandate that the entities it regulates impose costly margin requirements on non-financial counterparties. Is it your view that we must wait and see how costly and economically destructive these margin requirements may be before we fix such an obvious problem?

Answer. We should allow the regulators to complete their ongoing rulemakings, and provide ample time to evaluate the effects of regulatory reform. This period of time will help us determine what changes, if any, might be necessary in certain areas to improve the effectiveness of these reforms.

Question. On a related note, even key players in the passage of Dodd-Frank such as former Chairman Frank, Chairman Bernanke, Sheila Bair and Paul Volcker have been outspoken about the "push-out" provisions in Section 716 doing nothing to eliminate risk—in fact, perhaps increasing risk by moving swaps portfolios into less-capitalized entities—and instead doing much to increase the cost of using swaps by end users. Others cite Section 716 as a major impediment to the workability of Orderly Liquidation Authority, a primary tenet of the Dodd-Frank regulatory regime. Your view is that we should allow this harmful rule to go into effect, instead of fixing the train wreck we can all see coming?

Answer. In the last Congress, legislation was introduced to respond to criticisms made by market participants, including foreign banks, about Section 716. Regulators are still considering the best way to address the implementation of the swaps push-out provision. In a recent action, the Federal Reserve provided additional guidance in this area, demonstrating that regulators have the flexibility to respond appropriately to legitimate concerns.

We should allow the regulators to complete their ongoing processes, and provide ample time to evaluate the effects of regulatory reform. Taking up piecemeal legislation at this time is premature and would be disruptive and harmful to the implementation of key reforms.

Question. Are there any areas in which you feel Dodd-Frank could stand to be tweaked? Be they merely technical corrections, such as moving commas and the like, minor tweaks to correct oversights and drafting errors—such as the CFPB privilege bill that passed last year—or more substantive changes, are there any that you would envision supporting at this time?

Answer. The Dodd-Frank Act, like all pieces of legislation, is not perfect, but we have not identified any provisions that need to be clarified or improved that would affect the core areas of reform that are essential to strengthening the global financial system. The regulators have thus far been able to work to appropriately implement the Act without legislative adjustments. We should allow them to complete their ongoing rulemakings and only then determine what changes, if any, might be necessary to improve the effectiveness of these reforms.

Question. As the Congress works through the thorny problem of reforming the housing finance system, will you commit to us that the Treasury Department will give guidance as to what you would like to see in a reform proposal, and offer constructive commentary on any bipartisan proposals that the Congress pursues?

Answer. It is critically important that we move ahead with reforming the housing finance market and winding down Fannie Mae and Freddie Mac. Creating a more stable and sustainable housing finance market is an important priority of this Administration and I look forward to continue working on this issue with Congress.

The administration is committed to a sustainable housing finance system that does not allow the government-sponsored enterprises (GSEs) to return to their previous form, where private gains were allowed at the expense of taxpayer losses. Any future system must also protect taxpayers and financial stability, promote private capital taking on more mortgage credit risk in a responsible way, and meet the needs of our Nation's rental population. At the same time, we must preserve access to credit for American families, including long-term fixed rate mortgages and better-targeted Government support for low- and moderate-income Americans, including the development of affordable rental options. Our housing finance system must also include stronger and clearer consumer protections and must establish a level playing field for all participating institutions.

Question. As Chairman of the Financial Stability Oversight Council (FSOC), you have been tasked with taking a leadership role and solving the in-fighting between regulators, coordinating difficult rulemakings such as the Volcker Rule. Can you provide us any clarity on the progress being made on the Volcker Rule? Do you have any sense of when a final rule may be published, whether the rule will be re-proposed, or generally when we will make any progress at all?

Answer. Since the issuance of the Council's study on the Volcker Rule in January 2011, Treasury has been working to fulfill the statutory mandate to coordinate the regulations issued under the Rule. To meet this obligation, Treasury staff actively participates with the Federal banking agencies and the SEC and CFTC in the interagency process working to develop these rules. This process includes regular meetings that serve as constructive forums for the agencies to deliberate on key aspects of the rules. This process has resulted in the issuance of proposed regulations that were substantively identical, demonstrating a commitment among the agencies to a coordinated approach, and it continues as regulators work to finalize the rules.

Regulators are completing their review of the nearly 18,000 public comments to the proposed rules. Reviewing these comments takes time, and it is important for the rulemaking agencies to get the final product right. We take Treasury's role as coordinator seriously and remain committed to working with the rulemaking agencies towards a substantively identical final rule.

Question. At the hearing, you reiterated the criteria by which non-bank financial institutions are reviewed for systemic risk. My question, however, referred to the metrics or analytics used to evaluate such criteria, and whether they would be both industry-specific and open for public comment. For example, I don't believe it enough to say that you are looking at "interconnectedness," but instead, we should ensure that the methods by which you measure interconnectedness are sensible and tailored for the business line of the company you are examining. Please refer to the letter dated April 25, 2013 sent to you by Senator Tester and me for a more in-depth description of this issue. When can we look forward to your detailed reply?

Answer. As Treasury stated in our May 30, 2013, response to you and Senator Tester, the Council's final rule and interpretive guidance, which were issued on April 3, 2012, describe a three-stage process leading to a proposed determination, beginning with an initial stage using quantitative thresholds based on, among other things, measurements of size, indebtedness, and leverage. The Council's guidance describes how those thresholds help identify firms that could pose a threat to U.S. financial stability. By developing this set of uniform quantitative thresholds, the Council provided transparency to companies on whether they are likely to be subject to additional review. The second and third stages of the Council's determination process provide for a thorough evaluation of different types of nonbank financial companies based on quantitative and qualitative considerations and taking into account company- and industry-specific information as appropriate. The Council's interpretive guidance, which was subject to public notice and comment before it was issued, includes a number of sample metrics that the Council may use to assess interconnectedness and other considerations. In addition, the Dodd-Frank Act requires the Council to provide a nonbank financial company with an explanation of the basis of any proposed determination, and to report to Congress regarding the basis for all final determinations.

Question. Why, given the previous rejections of such adjustments, would the administration request funding for important IRS activities through a cap adjustment, which is clearly outside those exceptions to the discretionary spending caps outlined in statute by the Budget Control Act or 2011?

Answer. The program integrity cap adjustment will provide additional funding for IRS tax enforcement and compliance programs to improve fairness in the tax system, narrow the tax gap (estimated at $450 billion annually in taxes owed but not paid), and will reduce the deficit through increased revenue collections.

The IRS has demonstrated that targeted compliance resources such as these more than pay for themselves through increased revenues. In fiscal year 2012 alone, IRS enforcement activities returned over $50.2 billion in late or unpaid taxes to the United States Treasury. It is important to note that the non-partisan Congressional Budget Office scored the administration's similar fiscal year 2013 Budget multi-year cap adjustment proposal as generating net savings of over $20 billion over the budget window.

The $407 million program integrity cap adjustment funding proposed in the 2014 Treasury budget includes $323 million for traditional enforcement initiatives, $41 million for a revenue-enhancing enforcement initiative, and $43 million for other compliance program initiatives. An additional $5 million is proposed to generate new revenue at the Alcohol and Tobacco Tax and Trade Bureau.

This spending will have a high return on investment (ROI). Increased spending at the IRS on the traditional enforcement activities will generate more than $1.6 billion in additional annual enforcement, achieving an ROI of $6 to $1.

Unlike the 2013 Budget, the cap adjustment does not include funding for implementing the Affordable Care Act or other IRS legislative requirements, such as IRS's document matching program and the Foreign Account Tax Compliance Act. These legislative requirements are requested as a part of the regular discretionary request in the 2014 Budget. The program integrity cap adjustment is primarily reserved for revenue-generating enforcement activities.

Question. The Treasury Inspector General for Tax Administration (TIGTA) report indicates that IRS disagrees with two key IG recommendations, including the recommendation that IRS develop procedures to document reasons applications are chosen for review and the recommendation that IRS develop guidance on how to process requests for tax-exempt status involving potentially significant political campaign intervention. In a May 15, 2013 statement, President Obama stated that he "directed Secretary Lew to ensure the IRS begins implementing the IG's recommendations right away." Will you ensure that IRS implements the aforementioned two recommendations with which IRS disagreed?

Answer. Treasury believes that the tax code must be administered to the highest of standards and without bias. Treasury oversees the IRS with respect to matters of broad management and tax policy. The longstanding practice, spanning administrations of both political parties, is not to be involved in the details of tax administration and enforcement. Last month, the President appointed Daniel Werfel, a career public servant, to lead the IRS. On Mr. Werfel's first day on the job, Secretary Lew directed him to implement, fully and promptly, all nine of the recommendations in the Treasury Inspector General for Tax Administration's (TIGTA) report. As detailed in his written report delivered to Secretary Lew on June 24 [1], Mr. Werfel has taken quick action to implement all of the recommendations included in the TIGTA report.

[NOTE: The next 24 questions are addressed by RESPONSE #1 which is at the end of the last question and it appears under the heading (RESPONSE #1).]

Question. According to reports, Treasury Department officials were notified of the audit related to the use of inappropriate criteria to identify tax-exempt applications for review on more than one occasion. Please list the names and positions of all of the individuals within the Department of Treasury that were notified directly by the TIGTA and the dates on which they were notified or this audit was referenced or discussed.

Answer. *See* (RESPONSE #1).

Question. Did any employee of the Treasury Department, including the IRS, have any verbal, written or electronic communication with Secretary Geithner regarding any IRS action in relation to the scrutiny of tax-exempt applications?

Answer. *See* (RESPONSE #1).

Question. Was former Treasury Secretary Geithner or any of his direct reports ever made aware of the IRS using inappropriate criteria to target tax-exempt applicants or the TIGTA audit of such activity?

Answer. *See* (RESPONSE #1).

Question. Please provide the Committee with all written or electronic communication of the Department of the Treasury, including the IRS, pertaining to the targeting of applications for tax exempt status or the audit by the Inspector General, from calendar year 2010 to the present.

Answer. *See* (RESPONSE #1).

Question. Please provide the committee with detailed information on all interactions involving the Department of the Treasury regarding this audit, including email communications, phone calls and in-person discussions.

Answer. *See* (RESPONSE #1).

Question. When did you first become aware of Internal Revenue Service's (IRS) use of inappropriate criteria to identify tax-exempt applications for review?

Answer. *See* (RESPONSE #1).

Question. When did you first become aware of the TIGTA audit of IRS' review of organizations applying for tax-exempt status?

Answer. *See* (RESPONSE #1).

Question. When did the Department of Treasury first notify the White House of the IRS' use of inappropriate criteria to review non-profit groups applying for tax-exempt status?

[1] http://www.irs.gov/pub/newsroom/Initial%20Assessment%20and%20Plan%20of%20Action.pdf.

Answer. *See* (RESPONSE #1).

Question. When did the Department of Treasury first contact the White House regarding the TIGTA audit of the IRS using inappropriate criteria to review organizations applying for tax-exempt status?

Answer. *See* (RESPONSE #1).

Question. What Department of Treasury officials and White House officials were party to the earliest conveyance of information between the Department of Treasury and the White House regarding the activities described in the TIGTA report?

Answer. *See* (RESPONSE #1).

Question. What specific information was conveyed, and in what manner was the information conveyed, during the earliest communication between the Department of Treasury and the White House regarding the activities described in the TIGTA report?

Answer. *See* (RESPONSE #1).

Question. During press briefings on May 20, 2013 and May 21, 2013, White House Press Secretary Jay Carney stated that the Department of Treasury notified the White House Counsel's office on April 16, 2013 of the existence of the TIGTA audit, the report of which was ultimately issued on May 14, 2013.

—What specific information was conveyed by Treasury to the Counsel's office in the communication referenced above on April 16, 2013?

—How was the information conveyed?

—Please list all persons from the Department of Treasury and the White House that were party to the aforementioned communication of April 16, 2013.

—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to the aforementioned communication of April 16, 2013.

Answer. *See* (RESPONSE #1).

Question. During press briefings on May 20, 2013 and May 21, 2013, White House Press Secretary Jay Carney stated that the week of April 22, 2013, the Department of Treasury notified the White House Counsel's office of detailed information regarding the TIGTA report. Further, he noted that on April 24, 2013, White House Counsel Kathryn Ruemmler was notified by the Department of Treasury, either directly or indirectly through staff, in "full form," that, "the Inspector General for Tax Administration was completing a report about line IRS employees improperly scrutinizing what are known as 501(c)(4) organizations by using words such as 'tea party' and 'patriot.'"

—What specific information did Treasury convey to the White House Counsel or the White House Counsel's office during the communication referenced above from the week of April 22, 2013?

—When was this information communicated?

—What is the method by which this information was conveyed?

—Was this information communicated directly to White House Counsel Kathryn Ruemmler?

—Please list all persons from the Department of Treasury and the Counsel's office that were party to the aforementioned communication of the week of April 22, 2013.

—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to the aforementioned communication of the week of April 22, 2013.

Answer. *See* (RESPONSE #1).

Question. At any time during the communications between the Department of Treasury and White House Counsel's office from the week of April 22, 2013 that were described by Press Secretary Jay Carney on May 20, 2013 and May 21, 2013, did any White House personnel, specifically the White House Counsel or persons within the Counsel's office, communicate or indicate the intent to communicate information related to the TIGTA report or the activities described therein to White House personnel outside the Counsel's office? If so:

—When did such communication or indication occur?

—To which White House personnel outside the Counsel's office was the information conveyed or intended to be conveyed?

Answer. *See* (RESPONSE #1).

Question. At any time before, during, or following the communications between the Department of Treasury and White House Counsel's office the week of April 22, 2013 that were described by Press Secretary Jay Carney on May 20, 2013 and May 21, 2013, did any White House personnel, specifically the White House Counsel or persons within the Counsel's office, indicate to Treasury the intent to communicate information related to the activities described in the TIGTA report to White House personnel outside the Counsel's office? If so:

—When did all such indications occur?
—Which White House personnel made each such indication?
—To which Treasury personnel was such indication directed?
—To which White House personnel outside the Counsel's office was the information intended to be conveyed?

Answer. *See* (RESPONSE #1).

Question. During a press briefing on May 20, 2013, White House Press Secretary Jay Carney stated that following the communications between the Department of Treasury and White House Counsel's office the week of April 22, 2013, there were subsequent "communications between White House Counsel's Office and White House Chief of Staff's Office, with Treasury Office of General Counsel and Treasury's Chief of Staff Office to understand the anticipated timing of the release of the report and the potential findings by the IG."

—Through what media were these communications sent?
—On what dates and for what duration did the subsequent communications referenced above occur?
—Who initiated the subsequent communications described above?
—In what manner were these communications initiated?
—Please list all Treasury and White House personnel that were party to the subsequent communications described above.
—Were any individuals outside the Treasury Department and White House party to these communications?
  —If so, please list those individuals and any relevant affiliations.
—What specific information was conveyed in these communications?
—Did any of the subsequent communications not include the White House Counsel's office? If so:
  —Why did the communications occur directly between Treasury officials and White House officials without inclusion of the Counsel's office?
  —Is it standard practice for Treasury officials to discuss Inspector General audits with White House officials to this extent, prior to the official issuance of the audit report, while excluding the Counsel's office from the discussion?
—In these communications, did any White House or Treasury official raise the question of whether to inform President Obama of the TIGTA report or activities described in the report? If so:
  —What person or persons specifically raised the issue of informing the President?
  —What specific information was conveyed with respect to the question of informing the President?
—Was Director of the Exempt Organization function of the IRS, Lois Lerner, made aware of the subsequent communications described above?
—Did the subsequent communications described above include information regarding Director Lerner? If so:
  —Please describe such information in detail.
—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to the subsequent communication described above.

Answer. *See* (RESPONSE #1).

Question. Prior to May 10, 2013, did anyone within the Department of Treasury ever discuss with White House officials the method by which the public would become aware of the TIGTA report or the activities described in the report? If so:

—Who were party to such discussions?
—What potential methods of public disclosure were suggested in such discussions?
—Which individuals suggested each of these potential methods of disclosure?
—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to such discussions.

Answer. *See* (RESPONSE #1).

Question. Did anyone within the Department of Treasury ever discuss with Director Lerner the method by which the TIGTA report or activities described therein could be disclosed? If so:

—Please list the persons that were party to these discussions, as well as the disclosure methods that were discussed.
—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to such discussions.

Answer. *See* (RESPONSE #1).

Question. Did anyone within the Department of Treasury ever suggest to Director Lerner that information regarding the TIGTA report or activities described therein be disclosed in an unofficial manner? If so:

—Please list the individual or individuals who made such suggestion.

—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to such suggestion.

Answer. *See* (RESPONSE #1).

Question. Since May 10, 2013, has anyone within the Department of Treasury requested information from Director Lerner about the public disclosure of the existence of the TIGTA report or activities described therein? If so:

—What persons requested such information?

—What information has been requested?

—What information has been furnished pursuant to such request or requests?

—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to such requests.

Answer. *See* (RESPONSE #1).

Question. Since May 10, 2013, has anyone within the Department of Treasury requested information from Director Lerner about her knowledge of or role in the IRS using inappropriate criteria to review organizations applying for tax-exempt status? If so:

—What persons requested such information?

—What information has been requested?

—What information has been furnished pursuant to such request or requests?

—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to such requests.

Answer. *See* (RESPONSE #1).

Question. Did Director Lerner indicate to any person within the Department of Treasury that there was a possibility she would publicly disclose information regarding the TIGTA report or activities described therein? If so:

—When was such indication made?

—To whom was such indication directed?

—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to such indication.

Answer. *See* (RESPONSE #1).

Question. Since May 10, 2013, has anyone within the Department of Treasury requested the resignation of Director Lerner or suggested to Director Lerner that she resign?

Answer. *See* (RESPONSE #1).

Question. On May 23, 2013, it was reported that Director Lerner had been placed on administrative leave. Prior to May 23, 2013, did anyone within the Treasury Department communicate with anyone in the White House regarding the prospect of Director Lerner taking administrative leave? If so:

—Please list all persons within the White House and Treasury Department who were party to such communication.

—Please provide the Committee with copies of all emails, phone call logs, and other existing documentation related to such communications.

—For what duration will Director Lerner be placed on leave?

—While on administrative leave, will Director Lerner continue to receive pay?

Answer. *See* (RESPONSE #1).

(RESPONSE #1)

Answer. As stated in Congressional testimony, J. Russell George notified Treasury officials in June 2012 that he was beginning an audit regarding Section 501(c)(4) tax-exempt organizations. This notification occurred at approximately the same time that Mr. George initiated the audit. Mr. George also testified that he did not inform Treasury officials at the time of any results or audit findings. Treasury strongly supports the independent oversight provided by its three Inspectors General, and it does not interfere in ongoing IG audits.

Treasury first became aware of TIGTA's draft audit findings regarding Section 501(c)(4) tax-exempt organizations in March 2013. In mid-March 2013, TIGTA provided to the IRS, consistent with its standard practice, an initial draft report for the Section 501(c)(4) audit. Shortly thereafter, IRS staff described the general contents of the draft report to Treasury. In mid-April 2013, TIGTA provided an updated draft report to IRS staff. In late April 2013, after notifying TIGTA, IRS staff shared a copy of the updated draft report with Treasury. Because the report was not yet final, and consistent with standard practice, Treasury staff did not share it with the Secretary or Deputy Secretary. As the White House has previously said, the Treasury General Counsel's office first informed the White House counsel's office in April 2013 of the TIGTA audit.

On March 15, 2013, Mr. George had a short introductory meeting with Secretary Lew. At the meeting, Mr. George informed Secretary Lew of a number of matters

TIGTA was reviewing, including the forthcoming audit report regarding Section 501(c)(4) tax-exempt organizations. Mr. George, however, did not describe his audit findings. As he has testified to Congress, Secretary Lew first learned about TIGTA's findings when they were reported publicly in mid-May 2013.

On June 24, 2013, Mr. Werfel delivered a detailed written report to Secretary Lew on progress made at the IRS. Mr. Werfel has taken quick action to implement the recommendations included in TIGTA's report. In addition, Mr. Werfel reported on his progress in each of the three areas outlined by Secretary Lew: (1) ensuring staff that acted inappropriately are held accountable; (2) examining and correcting any failures in the processing of applications for tax-exempt status; and (3) taking a forward-looking systemic view at the IRS's organization. Mr. Werfel has taken important steps that further the goal of ensuring that the IRS administers the tax code to the highest of standards and without bias.

Mr. Werfel's 30-day review found no evidence of intentional wrongdoing at the IRS. In addition, Mr. Werfel's review found no evidence of involvement from anyone outside of the IRS in the behavior described in the TIGTA report. Finally, Mr. Werfel's review found no evidence of the use of inappropriate criteria in other IRS business unit operations. While more work remains, the assessments and actions outlined in Mr. Werfel's report have charted a path that will improve performance and accountability at the IRS. In addition, a series of independent reviews related to how the IRS evaluated applications for tax-exempt status under section 501(c)(4) are ongoing.

(END OF RESPONSE #1)

[NOTE: The next 6 questions are addressed by RESPONSE #2 which is at the end of the last question and it appears under the heading (RESPONSE #2).]

Question. Please provide information on all performance bonuses received by Treasury and IRS SES employees, career and non-career, including Presidential rank awards, and any other awards at IRS and Treasury from the beginning of calendar year 2010 to the present.

Answer. *See* (RESPONSE #2).

Question. Include documentation of the all deliberations and review by the Treasury Departmental Performance Review Board and the PRB's recommendations and ultimate decisions on awards for all SES positions for which the Secretary or Deputy Secretary is the appointing authority including identifying all recommending and approval officials. If the recommendation by the PRB was revised, please provide specific information regarding any change in the rating or amount or type of award.

Answer. *See* (RESPONSE #2).

Question. Please provide documentation for any and all performance awards provided to all Treasury and IRS SES employees, including career and non-career from the beginning of calendar year 2010 to the present. Also include all documentation of any board functioning as a performance review board.

Answer. *See* (RESPONSE #2).

Question. Please provide the names and positions of all members of the Departmental Performance Review Board and any other board that functions as a PRB for any SES, career or non-career, within the Department of the Treasury and IRS from calendar year 2010 to the present.

Answer. *See* (RESPONSE #2).

Question. Please provide information on each member of the Departmental PRB from calendar year 2010 to the present in their capacity as rating officials for other employees. List each position for which a member of the Departmental PRB serves as a rating or approving official. List all awards approved by each official from the beginning of calendar year 2010 to the present.

Answer. *See* (RESPONSE #2).

Question. Please provide information on all performance awards provided to any employee in positions under the responsibility of the Deputy Commissioner for Services and Enforcement including the Tax Exempt and Government Entities Division, Exempt Organizations, Rulings and Agreements, the Determinations, Guidance and Technical Units. List all awards for all positions from the beginning of calendar year 2010 to the present.

Answer. *See* (RESPONSE #2).

(RESPONSE #2)

Answer. Treasury is committed to being a careful steward of taxpayer dollars. Treasury adheres to guidance and budget limits established by the Office of Personnel Management (OPM) and the Office of Management and Budget (OMB) on employee awards.

(END OF RESPONSE #2)

[NOTE: The next 2 questions are addressed by RESPONSE #3 which is at the end of the last question and it appears under the heading (RESPONSE #3).]

Question. I am troubled by the administration's continued characterization of the depreciation schedules used by the General Aviation (GA) industry under Federal tax law. Key employers in the General Aviation industry have indicated to me on multiple occasions that market demand for services provided by the GA manufacturing sector decreases virtually every time the Administration uses language characterizing the GA industry as being comprised of or used by "fat cats" or "corporate big wigs." In other words, it is clear that the use of language demonizing the GA industry hurts people, and unacceptably targets a single industry because it makes for good political theater.

Is the Administration aware that the market for the consumption of aviation services varies substantially with the public use of language attacking the use of business aircraft, and that consequently, the labor force supplying the aircraft, and servicing the aircraft is directly affected by the use of language disparaging the GA industry?

Answer. *See* (RESPONSE #3).

Question. When Congress repealed the excise taxes on certain boats, aircraft, jewelry, and furs in 1993, Congress noted at the time, that

> "during the recent recession, the boat, aircraft, jewelry, and fur industries have suffered job losses and increased unemployment. The committee believes that it is appropriate to eliminate the burden these taxes impose in the interests of fostering economic recovery in those and related industries."

Does the Administration believe that extracting additional revenue from the GA sector through the use of the tax code, as proposed in the President's budget, will not result in contraction in economic activity in that sector?

Answer. *See* (RESPONSE #3).

(RESPONSE #3)

Answer. The Administration's fiscal year 2014 Budget proposes to conform the depreciation rules for airplanes not used in commercial or contract carrying of passengers or freight (general aviation passenger aircraft) to similar aircraft used in commercial transportation. Under current depreciation rules, the recovery period for general aviation passenger aircraft is 5 years and the recovery period for commercial passenger and freight aircraft is 7 years. The purpose of the Budget proposal is to level the playing field for different types of aircraft, because the shorter recovery period for depreciating general aviation passenger aircraft provides a tax preference in comparison to similar aircraft used for commercial transportation. Aircraft primarily engaged in non-passenger activities (for example, crop dusting, firefighting, and aerial surveying aircraft) would continue to be depreciated over a recovery period of 5 years.

(END OF RESPONSE #3)

QUESTIONS SUBMITTED TO STEVEN T. MILLER

QUESTIONS SUBMITTED BY SENATOR FRANK R. LAUTENBERG

IDENTITY THEFT

Question. Identity theft is a serious and growing problem in the United States and a daunting challenge for the IRS. Taxpayers are harmed when identity thieves file fraudulent tax documents using stolen names and Social Security numbers, and wrongfully receive refunds. Identity theft can be devastating for victims, whose legitimate refunds are blocked, forcing them to spend months untangling their account problems with the IRS.

What is IRS's current strategy for dealing with identity theft and refund fraud?

Answer. The IRS has a comprehensive strategy to combat identity theft focusing on preventing refund fraud, investigating these crimes, and assisting taxpayers victimized by identity theft. We have implemented, and continue to refine, our business processes to improve identification and prevention of tax fraud. Along with prevention, providing assistance to taxpayers whose personal information has been stolen and used by a perpetrator in the tax filing process is a key element in the strategy. Through the formation of specialized groups to process identity theft cases and the issuance of Identity Protection Personal Identification Numbers, or IP PINs (described in further detail below), we work to address all of the taxpayer's issues and prevent future instances of tax-related identity theft.

The investigative work done by the Criminal Investigation (CI) division is a major component of our efforts to combat tax-related identity theft. CI investigates and detects tax and other financial fraud, including identity theft, and coordinates with other IRS divisions to ensure that false refunds involving identity theft are quickly addressed. CI recommends prosecution of identity theft cases to the Department of Justice. In addition, we have been increasing our investigations of fraud related to identity theft, and expanding our efforts to work with local law enforcement and other Federal agencies in this area.

We have instituted a number of new procedures in the last few years to enhance our ability to prevent tax refund fraud using stolen identities.

—The Electronic Fraud Detection System (EFDS) identifies potential fraudulent returns. This system relies on data mining scores, fraud models and algorithms to determine the likelihood of fraud. As part of this process, we also look for similar attributes or characteristics such as a primary address that has been used multiple times on different returns or an IP address that is consistently used in the filing of fictitious claims.

—The IRS uses a process of income verification in its risk assessment to determine whether a return is fraudulent. We have accelerated the use of information returns (e.g., Form W–2) in order to identify mismatches earlier. Moving this matching process forward in time has enhanced our ability to identify fraudulent tax returns before we process them.

—In addition to EFDS, the IRS developed identity theft screening filters to improve our ability to spot false returns before we process them and issue refunds. For example, we designed and launched new filters that flag clusters of returns when certain characteristics are detected such as multiple refunds into a single bank account or to a single mailing address. While the development of effective filters is complex given the dynamic lives of legitimate taxpayers, these filters enable us to identify fraudulent returns even if a taxpayer's information has not been previously used for filing by an identity thief.

—One of our primary strategies to assist past victims of identity theft and prevent further fraudulent filings is the creation of an Identity Protection Personal Identification Number (IP PIN). The IP PIN program began in 2011 and has since been expanded and enhanced to protect victims of identity theft by creating an additional layer of security by requiring the IP PIN when filing a tax return. The IP PIN allows the IRS to more effectively identify fraudulent returns, while at the same time, validate that the return filed is the legitimate taxpayer's return. For the 2013 filing season, we issued more than 770,000 IP PINs and have improved processing of returns filed with an IP PIN. Additionally, the replacement IP PIN process (for taxpayers who lose or misplace their original IP PIN) has been significantly streamlined to provide better service. Taxpayers are asked to validate their identities by answering a series of questions for disclosure level authentication and if validated, they receive the replacement IP PIN at the point of contact.

—Beginning in 2008, we implemented the use of identity theft markers which are placed on a taxpayer's account to identify an identity theft incident. These markers are used to distinguish legitimate returns from fraudulent returns and prevent victims from facing the same problems every year. The markers provide additional protection from identity thieves by systemically evaluating taxpayers' future returns to check for inconsistencies and discrepancies that indicate potential fraudulent filing.

—We are also attempting to prevent the growing misuse of decedent social security numbers by detecting and stopping potentially fraudulent returns before they are processed. We are coding the accounts of deceased taxpayers who were previously victimized and where there is no longer a future filing requirement. This coding "locks" a taxpayer's account, preventing the acceptance of potentially fraudulent returns.

—The IRS is reducing the use of SSNs on our systems, forms, notices and letters to protect taxpayers from identity theft. In addition, the Administration's fiscal year 2014 budget includes a legislative proposal to grant the IRS authority to require or permit truncated social security numbers on W–2 forms that employers send to employees, to reduce the risk that the information could be stolen from a paper payee statement by identity thieves.

—To address tax refund fraud associated specifically with direct deposit to prepaid and other forms of debit and bank accounts, the IRS and Treasury's Financial Management Service (FMS) have collaborated with NACHA, the Electronic Payment Association, to develop an opt-in program for interested financial institutions to enable them to return ACH direct tax refund deposits if they suspect the transfers were based on fraudulent returns. The IRS Refund Return Opt-In Program will help the IRS examine the validity of refunds already issued and stop payment on or recover invalid refunds; build better pre-refund filters; and prevent future fraudulent refunds.

Question. What measures would make it easier for the IRS to stop thieves in their tracks?

Answer. The Administration's fiscal year 2014 budget request includes several important proposals needed to help us improve our efforts to stop refund fraud caused by identity theft. The Administration proposes to:

—Expand IRS access to information in the National Directory of New Hires for general tax administration purposes, including data matching and verification of taxpayer claims during processing;

—Restrict access to the Death Master File (DMF) to those users who legitimately need the information for fraud prevention purposes and to delay the release of the DMF for 3 years to all other users. This change would make it more difficult for identity thieves to obtain identifying information of deceased persons in order to file fraudulent returns;

—Grant the IRS the authority to require or permit truncated social security numbers on W–2 forms that employers send to employees, to reduce the risk that the information could be stolen from a paper payee statement by identity thieves;

—Add a $5,000 civil penalty to the Internal Revenue Code for tax-related identity theft; and

—Add the tax-related offenses in title 18 and the criminal tax offenses in title 26 to the list of predicate offenses contained in the Aggravated Identity Theft Statute under Federal law. A conviction for aggravated identity theft adds 2 years to the sentence imposed for the underlying felony.

Question. Do you agree with the concern expressed by the National Taxpayer Advocate that victims still face the same "labyrinth of procedures and drawn-out timeframes for resolution" that they faced 5 years ago?

Answer. The IRS has made significant changes in its procedures around identity theft, and we believe we have made significant progress in addressing the National Taxpayer Advocate's concerns. In October 2012, we established several identity theft specialized groups to assist with processing identity theft cases. The mission of these groups is to handle identity theft cases efficiently and with consistency. These groups provide a single point of contact based on origin of the problem thus eliminating the need for victims to interact with multiple units. This process also allows us to improve tracking and decrease the need for referrals among business units. Additionally, we now have more than 3,000 employees working identity theft issues, which is more than double the staffing resources dedicated to working identity theft cases in the previous filing season. In all identity theft situations, our employees work with each victim to resolve their particular situation. Identity theft cases are becoming increasingly complex, involving a manual authentication and review process to ensure we resolve the case satisfactorily for the victim. We are working to speed up case resolution, provide more training for our employees who assist victims of identity theft, and increase outreach to and education of taxpayers so they can prevent and resolve tax-related identity theft issues quickly.

Victims who have multiple issues crossing functions will continue to be monitored by the Identity Protection Specialized Unit (IPSU) and be given the IPSU number as their single point of contact for the IRS. They will not need to deal with the different functions individually. If they have questions about the status of their account, they will be able to call the IPSU.

Question. Is a 6-month wait for resolution of tax refund fraud cases acceptable to the IRS?

Answer. A 6-month wait is not acceptable. However, identity theft cases are complex, often encompassing multiple issues and tax years. Identity theft case work is growing rapidly. During fiscal year 2012, the number of cases received had grown to over 600,000. However, a number of initiatives put in place to frustrate identity thieves, and the application of additional resources, have reversed a multi-year trend and calendar year 2013 receipts are similar to calendar year 2012 receipts.

The IRS strives to set realistic taxpayer expectations to deal with identity theft issues. We continually review our policies and procedures to ensure we are doing everything possible to minimize the incidence of identity theft, help victims, and investigate perpetrators. Once a legitimate taxpayer's account is identified, marked, adjusted, and closed, it is the IRS's intent to ensure that future filings of returns by these taxpayers are protected from further harm or burden. Business rules are implemented to identify unique characteristics of fraudulent returns submitted by identity thieves, and used as a basis for rejecting them if these characteristics surface.

The IRS is dedicating a significant number of additional resources to identity theft. We have also implemented new procedures to resolve cases more efficiently and accurately, as well as found additional ways to reduce customer burden. New procedures are in place to identify the legitimate taxpayer's return, correct taxpayer account data and initiate refunds to identity theft victims more quickly. One such procedure added the use of Electronic Fraud Detection System data as a tool to determine the true SSN owner, thus eliminating numerous research steps and improving efficiencies. Additionally, new programming to identify returns with identity theft documentation attached was implemented. Cases are now generated directly to the specialized groups, reducing the amount of cases that pass through several areas.

Combating identity theft and providing victim assistance are top priorities of the IRS. We are committed to helping the victims of identity theft and, while more work remains, we have made significant progress. Our endeavors have resulted in increased closures and downward-trending inventories. Although we cannot stop all identity theft, our recent efforts provide a solid foundation upon which we will continue to build and improve.

Question. What additional resources—both technology and human capital—does the IRS need to expedite case resolution for innocent victims who often wait months for their rightful refunds?

Answer. The IRS continues its work in this area to identify false tax returns and prevent fraudulent refunds from being issued. The IRS has and continues to request additional funding through the budgetary process for additional staffing and advanced technologies to support continued efforts to handle the increased workload associated with identity theft and refund fraud. In the fiscal year 2014 budget request, there is a request for $101 million to support IRS efforts to prevent identity theft-related refund fraud, protect taxpayers' identities, assist victims of identity theft, and enhance the revenue protection strategy implemented in fiscal year 2013. The increase in funding will support the development and implementation of technology enhancements to identify noncompliant returns before refunds are issued, manage and track workload and case results, send notification letters to taxpayers, and allow third-party data to be used earlier in the filing season. Examples of technology solutions under development that would to help combat ID theft include:

—Development of e-File authentication technology to authenticate taxpayer identities through the issuance and maintenance of persistent credentials, as well as authenticate each tax return at the time of submission against these credentials, and

—Development of the Return Review Program (RRP) to screen questionable returns and improve detection, resolution, and prevention of identity theft and refund fraud.

Question. What is your reaction to concerns of the National Taxpayer Advocate about IRS's decision to decentralize and replace the "Identity Protection Specialized Unit" that IRS set up in 2008 to provide a one-stop shop for victims of identity theft?

Answer. The IRS's streamlined approach allows the IRS point of contact to be a person knowledgeable of the specific identity theft issue at hand and authorized to execute the actions necessary to resolve the problem. Accordingly, we believe it is a mischaracterization to state that the IRS is heading toward a decentralized approach in light of how the specialized groups function. The specialization process allows the IRS to utilize the unique skill sets and experience of dedicated employees, who work in strict accordance with service-wide policy, procedures, and processing timeframes that instill consistency and efficiency. Specialization not only provides a single point of contact for the taxpayer, but it also affords the taxpayer with the expertise needed to handle all aspects of their case. While we continue to explore ways to improve service to victims of identity theft, the Identity Protection Specialized Unit (IPSU) will continue to provide taxpayers with a single point of contact at the IRS via a special toll free telephone line, just as it has since its inception in October 2008.

AFFORDABLE CARE ACT

Question. The IRS has significant responsibilities in implementing and administering the Affordable Care Act (ACA), including taxpayer education and outreach, deliverance of tax credits, and development of new Information Technology (IT) infrastructure to support all of these areas.

Has funding been a challenge that the IRS faces as it implements and administers the ACA? If so, what parts of implementation and administration have been most affected?

Answer. Recent budget cuts and sequestration have been a challenge in funding all IRS functions. Prior to fiscal year 2013, the HHS Health Insurance Reform Implementation Fund (HIRIF) account funded IRS staffing and information technology development costs necessary to implement ACA. Without additional appropriations or HIRIF resources to continue the implementation of ACA in fiscal year 2013, the IRS has absorbed the costs of the staff, previously funded by HIRIF, into base resources and reprioritized current technology requirements to ensure IT resources are available to cover the costs for ACA IT needs. Although the IRS has absorbed the staff in the base for fiscal year 2013, this comes at the expense of not being able to fill behind attrition in critical IRS service, enforcement, and operations support programs. Additional user fees and other funds appropriated in fiscal year 2012 and available for 2 years (through fiscal year 2013) are also being used to continue this work. As a result of these actions all critical activities needed for the successful implementation and administration of the ACA have been funded to date, but at the expense of other programs resulting in the deterioration of taxpayer service availability and enforcement revenue, among other effects.

Question. How does your fiscal year 2014 budget request support successful fulfillment of the IRS's responsibilities in implementing and administering the ACA?

Answer. While the IRS has continued ACA implementation for fiscal year 2013 through a combination of absorbing personnel costs within base resources combined with the use of user fees and other funds that expire in fiscal year 2013, this is not a long-term funding solution. The fiscal year 2014 budget request will ensure that the IRS has the resources to continue implementing ACA—not only for the critical IT development but to address the anticipated increase for customer service through the call centers. Should IRS not receive the requested funding, it will be difficult to sustain the on-going requirements for fiscal year 2014 and beyond without degrading our IT infrastructure and eroding performance in service and enforcement programs.

Question. If the IRS fails to receive the funding it has requested, how will this affect its ability to implement the ACA as well as to meet its other responsibilities?

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 make long-term investments in information technology and workforce development. In general, for any given fiscal year, the IRS faces challenges when it does not receive the requested funding. For example, the IRS requested $360 million and 858 full-time equivalents in fiscal year 2013 for ACA implementation, but in the absence of this funding we have implemented short term solutions to deliver our fiscal year 2013 requirements, including determining what we could absorb within our reduced base funding.

Question. How is the IRS presently handling the immediate and time-sensitive IT development projects to ensure that functioning systems are in place for the premium assistance tax credit and other ACA features that take effect in 2014?

Answer. Upon enactment, the IRS took steps to implement governance structures and processes that provide transparency and oversight across all elements necessary to timely implement the tax provisions of ACA. As part of that structure, the IRS's IT organization established a Program Management Office (PMO) solely focused on implementation of the IT components of the ACA. Working in partnership with counsel and the IRS operational business units' leadership, these governance structures, supplemented with regular status and risks review meetings, independent reviews and other management disciplines, provide the IRS with visibility into the implementation status of the ACA program. These processes enable resolution of issues and give the IRS high confidence in its ability to timely deliver required applications.

In October 2013, the IRS will have systems in place to support the Marketplace Exchange Open Enrollment. We have made significant progress in this regard and the bulk of our systems development work is complete. To ensure the systems function as planned, in addition to internal testing, we are currently testing with the Health and Human Services Department's Centers for Medicare and Medicaid Services (HHS/CMS). We are also developing management processes that will be in place to ensure consistent support once the systems are operational.

We are preparing systems to receive periodic data (via the Data Services Hub being implemented by HHS/CMS) from the Exchanges. Implementation of this phase of development will begin in calendar year 2014. We are also preparing systems to incorporate the reconciliation of the premium tax credit into the individual tax filing process, which will begin with the 2015 tax filing season. In addition, we are developing the business requirements to support compliance processes associated with claimed credits. Implementation of this phase will begin with the 2015 filing season.

TAXPAYER CUSTOMER SERVICE

Question. Providing access to quality customer service helps taxpayers understand their obligations so they can pay the right amount on time. Staffing shortages due to budget cuts in recent years coupled with increased call volumes have adversely impacted the IRS's response to taxpayers' phone calls. The level of service has been severely declining. In 2004, the IRS answered 87 percent of calls seeking to reach a phone assister, with an average wait time of 2½ minutes. In 2012, the IRS answered just 68 percent of its calls, and those who got through spent an average of nearly 17 minutes waiting on hold.

How does the IRS define an "acceptable" level of service for taxpayers calling for assistance on the toll-free phones?

Will the level of funding in the fiscal year 2014 request help attain an acceptable level of service?

What factors could impede the IRS from attaining the level of service goal for 2014?

What setbacks might the IRS experience if resources in 2014 fall short of the request?

What steps is the IRS taking to be prepared for a potential surge in the call volume relating to taxpayer questions about the Affordable Care Act?

Answer. The fiscal year 2014 budget request reflects the increased call volume expected when several significant tax law provisions related to the ACA become effective in 2014. The IRS expects to answer approximately 7.7 million ACA-related telephone calls in 2014. Approximately 4.7 million calls are expected to be answered using automated services with about 3.0 million calls answered by telephone customer service representatives. With the requested funding in the fiscal year 2014 budget, the IRS projects a 79 percent level of service

Question. What lessons were learned from IRS experience when the call volume spiked in 2008 in response to the economic stimulus payments and the level of service dipped to 53 percent?

Answer. The IRS sets the Level of Service (LOS) target each year based on the projected telephone demand and the budgetary resources available. Our objective is to provide taxpayers with accurate telephone services while managing demand. This is achieved by:

—Improving IRS contact center efficiency;
—Enhancing the workforce customer assistance tools; and
—Reducing toll-free telephone demand by providing issue resolution alternative channels.

We monitor our toll-free performance to provide the most effective taxpayer service possible with allocated resources. The LOS goal for fiscal year 2013 is 70 percent, which is 3 percent higher than fiscal year 2012. The fiscal year 2014 budget request includes funding necessary to improve our toll-free customer service, and to attain a 79 percent LOS (based on projections prior to sequestration budget impacts). We also track the number of callers who hang up while waiting (i.e., abandon) relatively early in the call. When adjusted for early abandons, our toll-free LOS is almost ten percentage points higher than our standard LOS measure.

We actively work to improve our live taxpayer service as well as supplement with 24 x 7 automated services. The Where's My Refund (WMR) web application was enhanced with a status tracker in 2013. WMR now shows taxpayers how their refund is progressing through three stages: return received, refund approved, and refund sent. We also deployed a similar status tracker for amended returns (Form 1040X) in March 2013.

The availability of enhanced online tools and automated services has impacted the type and the complexity of the toll-free calls. Overall, the percent of complex, account-related calls has increased and the percent of brief tax law calls has decreased. This changing call mix means that our Customer Service Representatives (CSR) are answering more complex calls which increases the average handle time

(AHT) per call. In 2004 the AHT was 584 seconds (9.73 minutes). The AHT has steadily increased since, and by 2012, AHT had risen to 748 seconds (12.76 minutes). So far, fiscal year 2013 AHT is 676 seconds (11.26 minutes).

Unforeseen events can increase telephone demand such as the 2008 stimulus legislation. From fiscal year 2004 through fiscal year 2007, our telephone demand was steady. During this period the IRS achieved a CSR LOS at or above 82 percent. The stimulus legislation prompted an unprecedented number of taxpayers to call the IRS which had a significant negative impact on fiscal year 2008 CSR LOS. Demand for toll-free service did not return to pre-stimulus levels. Since fiscal year 2009, demand for telephone service has averaged about 18 percent above fiscal year 2007 levels.

To meet the taxpayer toll-free demand associated with the Affordable Care Act (ACA), the IRS developed detailed call volume and inventory projections, along with the anticipated staffing needs. Through the formal budget initiative process, we are requesting additional resources to meet the projected ACA telephone demand. In April 2013, we deployed a toll-free option where customers can get pre-recorded ACA information. If demand warrants, we are prepared to activate special announcements to redirect callers to ACA information on IRS.gov and HHS.gov websites. We continually update ACA information on the IRS.gov to ensure taxpayers have the most current information.

OVERSEAS TAX EVASION INITIATIVES

Question. U.S. taxpayers can hold offshore accounts for legitimate reasons, but they must comply with their tax obligations. Catching overseas tax dodgers is a top priority of the IRS to make sure honest taxpayers are not footing the bill for those hiding assets offshore. The IRS has operated some successful offshore compliance programs, such as the Offshore Voluntary Disclosure Program, that have recouped $5.5 billion in back taxes, penalties, and interest and provided an opportunity for 39,000 tax cheats to come clean. The 2014 funding request to support overseas tax evasion initiatives is conditioned on securing funds that would exceed the available budget cap. Without 2014 funding, the IRS will lack critical resources to meet overseas tax collection priorities.

What have been the benefits for the IRS in conducting the various Overseas Voluntary Disclosure Programs?

Answer. Global tax enforcement is a top priority at IRS, and we have made significant progress on multiple fronts, including groundbreaking international tax agreements and increased cooperation with other governments. In addition, the IRS and the Justice Department have increased efforts involving criminal investigation of international tax evasion. This combination of efforts helped support the 2009 Offshore Voluntary Disclosure Program, the 2011 Offshore Voluntary Disclosure Initiative (OVDI), and the ongoing 2012 Offshore Voluntary Disclosure Program . The goal of these programs is to get individuals back into the U.S. tax system and to turn the tide against offshore tax evasion.

The Offshore Voluntary Disclosure Programs have:

—Given U.S. taxpayers with undisclosed assets or income offshore an opportunity to become compliant with the U.S. tax system, pay their fair share and avoid potential criminal charges;

—Been effective in encouraging taxpayers to disclose unreported offshore income and so far have resulted in the collection of more than $5.5 billion in back taxes, interest, and penalties from approximately 38,000 participants;

—Provided the IRS with a wealth of information on various banks and advisors assisting people with offshore tax evasion, which the IRS is using to continue its international enforcement efforts.

Question. How is the IRS addressing the concerns raised by GAO that there are persons outside of these programs now declaring overseas assets but escaping any penalties?

Answer. The IRS is taking several steps, as described below, to address the concerns that persons outside the OVDI programs are reporting existing foreign accounts on the Form 1040, Schedule B, or on FBARs for the first time and circumventing some of the taxes, interests, and penalties that would otherwise be owed.

—The Large Business and International (LB&I) Director, International Individual Compliance received the quiet disclosure data gathered through the GAO report. This data will be reviewed and analyzed, and appropriate action will be taken to address identified noncompliance.

—The IRS is also analyzing filed Forms 8938, Statement of Specified Foreign Financial Assets, to identify specific characteristics of the filing population and to assess filing behaviors indicating potential compliance issues. This analysis includes a statistical analysis of filers (e.g., income, age, filing status) and several measures of year-to-year filing behavior (e.g., taxable income changes, FBAR filing history, and Schedule B reporting patterns). This data will also be evaluated against other indicators of compliance risk.

—In addition, the Director, International Individual Compliance will work with the IRS's Large Business and International Division (LB&I) research personnel to explore means of analyzing Form 1040, Schedule B, and FBAR filings to identify first-time FBAR filers who may be improperly reporting offshore accounts as new accounts. The IRS will take the necessary action to address any identified noncompliance.

Question. How will the IRS devote resources to the overseas initiatives in 2014 if the requested funds are not appropriated?

Answer. Offshore compliance will remain a key operational priority for IRS in fiscal year 2014. Our recent efforts have resulted in additional leads which we need to pursue. The proposed funding for overseas tax non-compliance is critical for pursuing these leads and in the development of additional enforcement activities such as John Doe Summons on facilitators and compliance actions on those taxpayers and advisors that have not or will not come forward voluntarily. If the requested funds are not appropriated, however, some of our offshore compliance efforts would be scaled back and IRS efforts to implement the Foreign Account Tax Compliance Act would be hindered.

Question. Can you confirm that—as presented in your 2014 budget justification—the requested funds for overseas compliance initiatives depend on securing resources above the statutory budget cap?

Answer. The fiscal year 2014 President's Budget includes the initiative Implement Foreign Account Tax Compliance Act (FATCA) that is funded within the statutory budget cap and the initiative Address International and Offshore Compliance Issues that is dependent on securing resources above the statutory budget cap through a program integrity cap adjustment. The cap adjustment and associated funding request are premised on the expectation that resources provided above the cap will return significantly more to the Treasury in the form of increased tax revenue than the activities will cost, thereby generating over $30 billion in net savings over 10 years.

The IRS continues to experience an increase in the number of international assistance requests from special agents in the field and our international law enforcement partners worldwide. Without the requested resources, the efficiency, effectiveness, and timeliness of the support we provide could be affected as we strive to fulfill a key component of our mission, combating offshore tax evasion and international money laundering. In addition, we will have to repurpose resources from other critical program areas to address this shortfall. Recognizing that international assistance is a priority, the repurposing of resources to this program could result in an increase in cycle time and/or a decrease in completions and initiations in other program areas. The IRS is committed to its goal of pursuing international tax evasion. However, without the requested funding, other mission areas will be stretched thin, which could negatively impact our overall efforts in support of the IRS' Strategic Plan.

The OVDI continues to improve taxpayer compliance as taxpayers are still applying to the program and working with the IRS to pay back taxes, penalties, and interest. However, we are now committing significant full-time resources to manage this program at the expense of other program areas. Additional funding would allow the Service to fill behind these OVDI resources to more effectively handle ongoing cases and identify new criminal investigations and emerging compliance issues.

THE TAX GAP

Question. The "tax gap" is the difference between the estimated amount taxpayers owe and the amount voluntarily and timely paid. An estimated $450 billion of Federal taxes are unpaid each year, for a noncompliance rate of nearly 17 percent. Collecting unpaid taxes is an enormous untapped source of Federal revenue that could fund many worthy unmet national needs. The bulk of the tax gap is attributable to underreporting of tax liability. One important way to tackle the problem of underreporting is for the IRS to intensify its work to obtain and match third-party information.

What are the components of the IRS's strategy to narrow the tax gap?

Answer. The tax gap stems from both intentional tax avoidance and unintentional mistakes that arise from a complex tax code. For that reason, IRS maintains a comprehensive strategy to increase tax compliance through a combination of enforcement activities coupled with third-party reporting requirements and programs to educate taxpayers about their tax obligations and make it easier to fulfill their filing and payment requirements. IRS efforts to address the tax gap and improve tax compliance follow four guiding principles:

—Both unintentional taxpayer errors and intentional taxpayer evasion should be addressed;
—Sources of noncompliance should be targeted with specificity;
—Enforcement activities should be combined with a commitment to taxpayer service; and
—Policy positions and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

Achieving greater voluntary compliance and shrinking the tax gap involves a comprehensive, integrated multi-year strategy. Along with increased enforcement activities, components of this strategy also include: reducing opportunities for tax evasion, expanding compliance research, improving information technology, enhancing taxpayer service, reforming and simplifying the tax law and coordinating with partners and stakeholders, such as States and foreign governments, to share compliance strategies. Recent efforts include:

—Launching a multi-faceted return preparer strategy;
—Improving risk-based audit selection for business tax audits;
—Establishing a voluntary worker classification settlement program;
—Implementing new basis reporting requirements for financial securities;
—Instituting merchant card reporting requirements that provide third-party data on business receipts for the first time;
—Addressing offshore tax avoidance;
—Requiring disclosure of uncertain tax positions for certain large corporations;
—Significantly augmenting our efforts to detect and prevent refund fraud, including identity theft schemes;
—Addressing improper EITC claims through outreach and enforcement;
—Improving our ability to identify nonfilers and underreporters; and
—Investing in research to identify compliance risks and improve compliance.

The IRS has published more details about this strategy on the web. You may find it on: http://www.irs.gov/pub/newsroom/tax__gap__report__-final__version.pdf

Question. How are appropriated funds in 2013 being channeled to address the tax gap?

Answer. Increasing the rate of voluntary compliance is the most cost-effective way to reduce the tax gap. The IRS remains committed to improving voluntary compliance and reducing the tax gap through the balance of taxpayer service and enforcement programs along with operations support activities. Approximately 64 percent of IRS appropriated funds are allocated to the Taxpayer Services and Enforcement accounts and the remaining 36 percent are allocated to the Operations Support and Business Systems Modernization accounts, which provides critical infrastructure and systems investments and support for the IRS's core activities. Over the last several years IRS has focused on areas that promote voluntary compliance including increasing the amount of information and services available to taxpayers through online and social media.

Question. How will funds requested for 2014 be devoted to increased information reporting?

Answer. The fiscal year 2014 President's Budget requests funding to implement new information reporting requirements resulting from enactment of recent legislation. This includes resources in the:

—*Implement Foreign Account Tax Compliance Act (FATCA)* initiative to improve offshore compliance by implementing new information reporting enacted in FATCA that was included in the Hiring Incentives to Restore Employment Act of 2010 (Public Law 111–147);
—*Implement Merchant Card and Basis Matching* initiative to allow the IRS to take advantage of the reporting provisions of the merchant card and third party reimbursements enacted in the Housing and Economic Recovery Act of 2008 (Public Law 110–289) and the basis reporting on security sales enacted in the Emergency Economic Stabilization Act of 2008 (Public Law 110–343); and
—*Implement IT changes to Deliver Tax Credits and Other Requirements* initiative to implement the new information reporting requirements for Federal and State exchanges, certain large employers, and insurance issuers contained in the ACA (Public Law 111–148).

Question. To what extent is the IRS's ability to require better or more robust information reporting hampered by the lack of legislative authority?

Answer. All information reporting requirements need to be authorized by law. The IRS implements whatever requirements are imposed by the law through specific regulations, forms, and procedures. From time to time IRS works with Treasury's

Office of Tax Policy to propose new information reporting requirements for consideration by Congress. This collaboration resulted recently in new information reporting requirements related to merchant card transactions and the cost basis on the sale of securities.

Question. Absent enactment of legislative reform, are there any purely administrative actions that the IRS can pursue that will yield additional revenue?

Answer. Administrative actions would involve trade-offs. For example:

—Absent legislative reform, it would be possible to yield additional revenue by expanding current IRS activities, but that would require increasing the IRS budget. It is clear, however, that increases in the budget would result in revenue gains that far exceed the budget increase.

—In the absence of additional investments, it would be possible to reallocate some existing resources subject to various statutory constraints (which is somewhat constrained by separate legislated appropriations). However, given that the primary impact of IRS activities is to promote voluntary compliance, and that changes in *voluntary* compliance behavior cannot be observed in isolation, estimating the magnitudes of these effects is still a matter of active research.

—Finally, IRS is continually pursuing new efficiencies, enabling us to do the same things with fewer resources. But these generally rely on emerging technologies that require up-front investments, and are often dependent on changing taxpayer preferences, which typically happens gradually.

EFFECTS OF BUDGET REDUCTIONS/CONSTRAINTS

Question. In fiscal year 2013, the IRS is operating with a budget that is almost $1 billion below the fiscal year 2011 enacted level, and, as a result, the IRS has 8,000 fewer full-time employees than just 2 years ago.

To what extent are reductions to IRS's budget limiting its modernization initiative, and how has IRS's ability to deliver key services to taxpayers been affected?

Answer. The IRS has gained efficiencies in the IT organization by adopting the Information Technology Infrastructure Library (ITIL) approach to IT service management, which includes best practices drawn from public and private IT organizations internationally. The IRS has also matured management control processes in its IT applications development organization by applying the respected Capability Maturity Model Integration (CMMI) methodology. With several years of budget reductions, the efficiencies gained by applying these standards across our IT organization afforded IT support of the annual delivery of filing season and other application changes, while also taking in new work such as the implementation of new legislation, including the Affordable Care Act.

However, these ongoing budget reductions and reduced staffing levels are unsustainable. The IRS is taking action to slow its modernization efforts, which will delay business and taxpayer benefits and influence the overall level of service that the IRS could provide. Delays can be expected in the following project areas:

—Development of the Customer Service Data Engine (CADE2). The IRS is experiencing limitations in moving forward with Transition State 2 (TS 2) in building infrastructure, developing systems, and delivering planned functionality. Specifically, TS 2 prototype work is being slowed, which is affecting efforts such as: identifying new mechanisms by which data will be delivered downstream, deciding how system performance is affected by encrypting data between two applications and developing capabilities to ensure CADE 2 generates the same business results that the existing core business systems generate. This will further delay delivery of planned functionality that will offer business benefits such as enhanced protection from fraud and identity theft, improved accuracy and consistency of service, system changes to address the unpaid assessments relating to the financial material weakness, and enhance maintainability, traceability, and flexibility of our core tax processing systems.

—Ongoing development of the Modernized e-File project, which serves as the primary external point of interaction for all electronic tax filings. The benefit is electronic access to tax return data, which significantly reduces the handling/mailing of paper returns and increases service to the taxpayer. Delays in this project result in the following:

  —Delays the IRS's Customer Service Representatives' (CSRs) ability to provide faster responses to taxpayers.

  —Delays the provision of online capabilities that will enhance compliance and enforcement activities by allowing access to taxpayer data in a timely and accurate manner.

—Delays retirement of the legacy Electronic Management System (EMS), which would reduce future operations and maintenance budgets. (The EMS cannot be retired until MeF can support all forms.)

—Delay in infrastructure replacement. Taxpayers rely on the IRS's information technology infrastructure to ensure reliable satisfaction of their tax liabilities and quick resolution of any issues that might arise as they meet their tax obligations. IRS employees rely on the information technology infrastructure as they work to ensure a high level of service to both taxpayers and the Federal Government. The core technology systems that the IRS uses to manage taxpayer data and facilitate their service and enforcement work were groundbreaking when first created. However, they have not kept pace with rapid innovations in technology and the explosion in online interaction. This limits the new capabilities the IRS can deliver to its employees and taxpayers.

—Delay in development of the Return Review Program (RRP) program. RRP is a system in development that will use leading-edge technologies to advance IRS effectiveness in detecting, addressing and preventing tax refund fraud, and protecting the U.S. Treasury revenue. It will replace the legacy Electronic Fraud Detection System (EFDS) built in the mid-1990s. The entirely new RRP fraud framework is critical for IRS success in tackling ever-evolving tax schemes in a sophisticated, scalable and adaptable manner. Using massively parallel processing, the system's capacity will promote speed, even during the peak of tax filing season. This speed will serve taxpayers not only by supporting fast refunds, but also by quickly recognizing patterns and redirecting fraudulently filed returns. The database query speed will be more than 10 times that of the current EFDS system. Delay of RRP has a negative impact on taxpayers, tax enforcement, and review protection.

Question. Are there any further actions the IRS can take to help mitigate the negative effects of these budget cuts?

Answer. As mentioned above, the IRS has managed through budget reductions for the past several years and the IT organization has taken steps to become leaner and more efficient. To cope with the budget and people constraints, the IRS is prioritizing IT deliverables in a manner that minimizes the effect on taxpayers; however, going forward it is expected that these constraints will show a decline in level of service. In addition, IT is exploring steps to reduce the year-to-year maintenance footprint such as fewer hours of internal help desk support and reduced maintenance service level contracts.

Question. What program areas do you anticipate being most negatively affected by the reductions to the IRS base budget?

Answer. We anticipate continued and significant degradation of several core functions, including: the level of service taxpayers receive when they interact with the IRS; enforcement programs and resulting revenue; and support levels for our IRS internal business and functional operating divisions. In addition, IRS will need to reduce the hardware and software replacement/refreshment activities on some of our key IT projects, which increases the operational risk. It will also need to consider discontinuation of enhancements/improvements of some applications for the IRS business operating divisions.

Question. Which performance metrics may show a negative trend because of budget reductions/constraints?

Answer. The IRS has maintained an exception only hiring freeze since December of 2010 that has resulted in a reduction of 8,000 full-time employees. IRS can only sustain so much of a reduction before performance is impacted, and IRS expects that taxpayer service programs such as IRS telephone Level of Service and correspondence inventory metrics will suffer. In addition, enforcement program metrics such as individual and business audits and audit/examination coverage rates, Automated Underreporting contact closures, collection actions and appeals case closures will be impacted, all resulting in the likelihood of lost direct enforcement revenues.

TAXPAYER SERVICE AND COMPLIANCE PROGRAMS

Question. I understand the IRS is currently making plans to address budget reductions resulting from sequestration. This will mean a reduction of approximately $689 million in discretionary funding.

How will taxpayer service and compliance programs be affected?

Which taxpayer services and compliance programs will be reduced?

Can the IRS use transfer authority in any way to help absorb the reduction?

Answer. Based on the nature of sequestration and the rescission, IRS applied the reduction equally across all IRS accounts meaning that every taxpayer service and compliance program was affected by the reductions. However, the actions IRS has taken since fiscal year 2011 have helped the IRS manage within budget levels impacted by sequestration and other budget cuts. Furthermore, although the cut was across all programs, to help mitigate the impact on employees funded by different appropriations, the IRS fiscal year 2013 operating plan requested and received approval for the use of transfer authority. This transfer authority helped balance the impacts of the reductions and supported the plan for up to seven furlough days by every IRS employee.

BUDGET CONTROL ACT

Question. The President's budget requests that $411.9 million in IRS tax enforcement expenditures be exempted from the Budget Control Act (BCA) spending caps under a program integrity cap adjustment. But, as you know, the BCA does not allow for an IRS program integrity cap adjustment, which would allow IRS spending in excess of the BCA spending caps.

If Congress fails to amend the Budget Control Act, and the IRS does not receive this $411.9 million in requested funding, how much of a deficit increase can we expect?

Answer. The IRS estimates that the initiatives funded through a program integrity cap adjustment will reduce the deficit by generating $1.6 billion in additional annual enforcement revenue once the new hires reach the full performance level in fiscal year 2016. Over the 10-year-budget window, the costs and savings associated with maintaining these initiatives and conducting new activities via the funds provided by the cap adjustment is estimated to generate $32.7 billion in net deficit savings. If IRS does not receive funding for the program integrity cap adjustment initiatives, the result would be a missed opportunity to reduce the deficit.

SUPERSTORM SANDY DISASTER TAX RELIEF PACKAGE

Question. As a member of the Senate Appropriations Committee, I co-authored the Superstorm Sandy emergency supplemental funding package that provided a total of $60.2 billion in disaster aid funding to Sandy-affected States. Unfortunately, the Senate and House have not yet passed legislation that would provide tax relief to Sandy victims. In the past, disaster-affected taxpayers have been granted a range of tax relief, including the ability to fully deduct disaster cleanup expenses and make penalty-free withdrawals from retirement accounts to pay for disaster recovery.

By what date would a Sandy disaster tax relief package have to be passed and signed into law in order for the IRS to have sufficient time to prepare tax forms and appropriate guidance for taxpayers to file for relief on their 2013 income tax returns?

Answer. Superstorm Sandy occurred in late October 2012 with disaster recovery activities continuing into 2013. Internal Revenue Code § 7508A, "Authority to postpone certain deadlines by reason of Presidentially declared disaster or terroristic or military actions," allowed the IRS to provide administrative tax relief to Superstorm Sandy victims as soon as Superstorm Sandy was designated as a Presidentially declared disaster. Taxpayers who sustained a casualty loss from Superstorm Sandy were eligible, under Internal Revenue Code § 165(i), to claim their eligible loss on their prior year return allowing for a quicker tax refund. Information and frequently asked questions for disaster victims can be found on IRS.gov: http://www.irs.gov/uac/Tax-Relief-in-Disaster-Situations.

For tax year 2012, taxpayers who did not elect to claim their eligible loss on an amended 2011 tax return can claim their loss on their 2012 tax return. If legislation is passed providing additional relief for victims of Superstorm Sandy, taxpayers would either file an amended return to take advantage of the relief provisions or include them in their original 2012 year return if still on a valid extension.

For tax year 2013, the IRS would incorporate any legislative changes into the applicable forms, instructions, and publications (if the legislation is enacted in time to make changes before the end of the calendar year). Regardless of when legislation is enacted, the IRS would issue guidance on IRS.gov to quickly reach the largest number of taxpayers.

CAPITAL GAINS TAXES

Question. The IRS has requested increased funding to help taxpayers understand and comply with a new requirement to report the cost basis used when calculating capital gains and losses on stock sales. This requirement is intended to help ensure that taxes owed are paid. In order to assist with compliance, investment firms are required to provide their clients and the IRS with cost basis information whenever shares of a stock purchased after January 1, 2011 are sold. However, most stocks sold are likely to have been purchased before 2011.

What steps is the IRS taking to ensure that the correct amount of capital gains taxes owed on sales of stock purchased before 2011 are paid?

Answer. For transactions that pertain to stock purchased before 2011, the IRS continues to address underreporting of stock transactions through our traditional Compliance Programs. The IRS works with the taxpayer to verify the basis reported on the taxpayer's Schedule D, Capital Gains & Losses.

Stockholders must retain purchase documentation along with any adjustments to cost basis during the time period they owned the stock. The IRS has provided information to assist taxpayers with the record-keeping requirements for stock purchases, on how to address basis adjustments over the time the stock was held by the taxpayer, and how to report capital gains or losses of stock. For example, IRS Publication 17, Your Federal Income Tax Return (For Individuals); Publication 550, Investment Income and Expenses; and Publication 551, Basis of Assets, offer detailed guidance and instructions on these topics. Although brokerage firms are not required to report basis to IRS on stock purchased prior to 2011, they often do report the basis to their customers. This should also assist taxpayers in voluntarily reporting the gain/loss from stock transactions.

The IRS is working to establish new examination selection criteria regarding *Schedule D, Capital Gains & Losses,* using the new cost basis information. The IRS continues to reach out to and partner with external stakeholders to gather and share information about how basis computation issues may affect brokerage firms, practitioners, and taxpayers. The result of these types of exchanges are shared with IRS/Treasury Counsel and as appropriate, are posted to irs.gov to provide additional guidance to all interested parties. IRS utilizes a variety of e-Services tools to communicate this information and, where feasible, by having a presence at various professional meetings/organizations or taxpayer outreach initiatives.

Question. Because the cost basis of a stock is affected by corporate actions such as mergers, stock splits, and spin-offs, it can be difficult both for taxpayers and the IRS to determine cost basis even when the share purchase dates are known. Does the IRS have software that incorporates information about corporate actions and allows the IRS to easily determine whether a taxpayer has calculated cost basis correctly?

Answer. No, the IRS does not have this type of software readily available. Form 8937, Report of Organizational Actions Affecting Basis of Securities, is a new form generally required if you are an issuer of a specified security that takes an organizational action that affects the basis of that security. For example, you must file Form 8937 if you make a nontaxable cash distribution to shareholders or if you make a nontaxable stock distribution to shareholders, including a stock split. This filing requirement applies to organizational actions after 2010 and includes providing such information to each holder of record. The regulations do allow for optional reporting via the corporation's public web site as an alternative to filing/furnishing Form 8937. In that instance such information must remain on the entity's web site for 10 years.

Question. Would the IRS be willing to make available on its website a cost basis calculator to help taxpayers comply with the new requirements?

Answer. The IRS would certainly consider this to help taxpayers comply with new requirements or otherwise reduce the burdens they face. However, due to such actions as mergers, stock splits and spin-offs, the development and maintenance of this type of program would be costly and challenging in the current environment where the IRS is facing a shrinking budget and staffing shortages.

QUESTION SUBMITTED BY SENATOR TOM UDALL

Question. In your answer to my question about the qualifications and profile of IRS employees you shared that they are reflective of the communities they are in. While I understand that IRS employees vary by region, please provide the following statics for the national average IRS employee:

—Total years of government service;

—Years of service in the IRS;

—Age;

—Years of education; and

—Revenue collected.

Answer. At the end of the last pay period of fiscal year 2012 (09/22/2012) the IRS had 97,942 employees on the rolls in all functions. These 97,942 employees had the following demographic characteristics:

—Average years of government service: 15.92
—Average years of IRS service: 14.95
—Average age: 48.08 years old
—Average years of education: 14.34 (where 14 would be an associate's degree and 16 would be a bachelor's degree).

The IRS does not track or report enforcement revenue collected by employee, but reports on Return on Investment (ROI) based on the annual enforcement revenue collected and annual appropriated budget. For fiscal year 2012, the IRS enforcement revenue collected was $50.2 billion. Based on the IRS budget of $11.87 billion, this level equates to an ROI of $4.25 for every $1 appropriated to the IRS.

QUESTIONS SUBMITTED BY SENATOR MIKE JOHANNS

Question. In the hearing, you explained that you will have to use a use a "lighter touch" when it comes to enforcing the healthcare law's individual mandate, because that law specifies that normal tax collection rules will not apply. When will you have details about how the IRS intends to enforce the mandate? Do you believe that the way the law was written will make it difficult to enforce the mandate?

Answer. Most Americans already have health insurance coverage either through their employer, a government program like Medicaid or TRICARE, or a family member. In addition, many people will qualify for one of the statutory exemptions provided in the individual coverage provision itself. Taxpayers will be able, on their annual Form 1040 return, to indicate fact of coverage, indicate which exemption applies to them, or enter a shared responsibility payment amount on the return. As with many new provisions, we are focusing on educating taxpayers and building practical products related to the tax filing process. Our efforts also include both partnering with HHS to increase citizen awareness of opportunities to acquire affordable health insurance coverage and making the appropriate changes to IRS IT and business infrastructure.

Most taxpayers are highly compliant and when they have tax liability they make a payment with their return. For those who do not remit payment related to the individual coverage provision, the IRS will communicate with the taxpayer and attempt to resolve the outstanding liability. Like any "balance due" remaining on an account, if a future return would result in a refund, normal rules will offset the existing balance due against the new refund. The provision is unique in that it contains a prohibition on the use of particular collection processes such as liens or levies.

Question. How does implementation of the Affordable Care Act change the workforce needs at IRS? What percentage of the IRS workforce is now doing work related to implementation of the healthcare law? What does this percentage need to be in order for you to adequately enforce the law? And have you outlined the agency's workforce needs over the next 5 and 10 years in relation to the healthcare law? If not, will you commit to doing so and sharing this information with us?

Answer. For fiscal year 2012, the IRS had just under 700 full-time equivalent staff working on the tax law changes in the ACA. Our fiscal year 2013 budget requested 858 full-time equivalents, about 70 percent of which is for IT implementation and program management. This represents less than 1 percent of the IRS's total workforce. In fiscal year 2014, the IRS will continue supporting the ACA by building new systems and modifying established IRS systems and processes. In addition, the IRS expects a significant increase in demand for customer service through telephones and paper correspondence. The IRS anticipates additional needs over the next few years as ACA provisions are phased in through 2016.

Question. There is broad concern that it is hard to capture the true cost of the Affordable Care Act. For example, the President's budget proposes $440 million for the Affordable Care Act in the fiscal year 2014 budget. The overall operating plan for IRS for fiscal year 2013 describes $75 million in transfers from the Enforcement account to the Taxpayer Service account ($13 million) and the Operations Support account ($62 million). Are these transfers related to implementation of the Affordable Care Act? Is the IRS yet able to provide us with a plan on how it intends spend money to implement the Affordable Care Act in fiscal year 2013? Do you intend to use additional user fees, transfers from other accounts or other unobligated funds available to continue this work?

Answer. The "up to" $75 million of transfer authority requested in the fiscal year 2013 Operating Plan is to enable the IRS to minimize the impact of sequestration on IRS employees by providing the IRS the flexibility to manage resources and balance the number of furlough days evenly across all appropriations. This imbalance, which is due primarily to the difference in the number and cost of FTE in each account as well as the large amount of fixed costs (rent and IT infrastructure) in operations support, is not directly related to implementation of the Affordable Care Act. Without additional resources in fiscal year 2013, the IRS has absorbed the staff previously funded by resources from the Health and Human Services Department's (HHS) Health Insurance Reform Implementation Fund (HIRIF) account. Additional user fees and two-year funds authorized in fiscal year 2013 are also being used to continue this work.

Question. On a related note, how does the IRS plan to implement the Affordable Care Act if additional funding is not received in fiscal year 2014 and beyond? How will you prioritize your long list of responsibilities? Will you have to choose between enforcing the law's penalties and delivering customer service as the Inspector General mentioned in the hearing?

Answer. The fiscal year 2014 budget requests $440 million for the IRS to continue implementing the Affordable Care Act. The majority of this funding covers the staffing and IT costs previously funded by HHS's Health Insurance Reform Implementation Fund (HIRIF). Although IRS has absorbed the staff in the base for fiscal year 2013, this comes at a cost of not being able to fill behind attrition in other critical IRS service, enforcement and operations support programs. Additionally, fiscal year 2012 two-year funds that expire in fiscal year 2013 will not be available in fiscal year 2014 and user fee balances cannot sustain the on-going requirements for fiscal year 2014 and beyond—especially with the increased staffing requirements in taxpayer service to address the projected growth in demand resulting from individuals, businesses and third parties affected by the implementation of the Affordable Care Act—without significantly degrading performance in service and enforcement programs.

Question. How much of an impact has the cost of implementing Affordable Care Act had on the IRS budget and the need for furloughs in fiscal year 2013?

Answer. Due to the one time availability of expiring fiscal year 2012 IT funds and user fees, the IRS was able to mitigate a portion of the impact of not receiving the funding requested to implement the Affordable Care Act in fiscal year 2013. Although the IRS also absorbed the cost of staff working on ACA through savings resulting from unfilled attrition in other IRS program areas, while this did impact the IRS's ability to fill behind critical vacancies, it did not have a significant impact on the need to furlough under sequestration.

Question. I've heard a number of concerns about the information technology systems IRS must quickly design and implement to carry out key provisions of the law. What progress have you made on this large and complicated network of systems and when do you expect the various components to be complete?

Answer. There are over 45 tax-related provisions in the legislation. Many of these involve new technology systems and/or modifications to existing operational systems and infrastructure. While the IRS is currently preparing for implementation and administration of the provisions that will become effective in 2014, it is important to note that several tax-related provisions have already gone into effect and have been successfully supported by information technology. Some of those implemented in 2010 include: Small Business Health Care Tax Credit, Qualifying Therapeutic Discovery Project Credit, Excise Tax on Indoor Tanning Services, and Adoption Credit Expansion. Charitable Hospital Reporting and the Branded Prescription Drug Industry Fee were implemented in 2011. Each of these required updates in 2012 and 2013.

In October 2013, the IRS will have systems in place to support the Marketplace Exchange Open Enrollment. When an individual seeks to purchase insurance through a Marketplace and seeks financial assistance, the Marketplace must determine what assistance, if any the applicant may qualify for. To make that determination, the Marketplace will request Federal taxpayer data from us, and we will provide, for each applicant, some limited tax data from the applicant's most recently filed Federal income tax return. The IRS is also responsible for providing a computation service if the Marketplace determines that the applicant is eligible for and interested in, advance payments of the premium tax credit, which are sent to the individual's insurance company. Without identifying the applicant, the Marketplace will submit a few data elements, including income and family size, for the IRS computational services through the HHS data hub, and receive back a single figure. The figure represents the maximum advance premium tax credit resulting from those inputs. We have made significant progress in this regard and the bulk of our systems development work is complete. To ensure the systems function as planned, in addition to internal testing, we are currently testing with HHS/CMS. We are also developing management processes that will be in place to ensure consistent support once the systems are operational.

We are preparing systems to receive periodic data (via the Data Services Hub being implemented by HHS/CMS) from the Exchanges. Implementation of this phase of development will begin in early calendar year 2014. We are also preparing systems to incorporate the reconciliation of the premium tax credit into the individual tax filing process, which will begin with the 2015 tax filing season. In addition, we are developing the business requirements to support compliance processes associated with claimed credits. Implementation of this phase will begin with the 2015 filing season.

Question. The IRS developed a definition of "preventive care" that has applied to Health Savings Accounts (HSA) since their creation in 2003. The Affordable Care Act created a new definition of "preventive care" that is inconsistent with the IRS definition for HSA-qualified plans. Does the IRS plan to modify the definition of "preventive care" for HSAs so that they are not disqualified from participating in the healthcare law due to this technical difference?

Answer. The IRS released Notice 2013–57 on September 9 to address the issue raised in the question. The notice is linked on the IRS.gov webpage: http://www.irs.gov/pub/irs-drop/n-13-57.pdf.

QUESTIONS SUBMITTED TO HON. JACOB J. LEW AND STEVEN T. MILLER

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

Question. Over the past year, the IRS has had a number of allegedly "inadvertent" releases of protected, confidential taxpayer information. Most of these relate to the improper release of Schedule B of Form 990 listing donors to nonprofit organizations. The IRS made these improper releases of information about nonprofit groups in response to information requests from other groups that subsequently used this information to attack the organizations and their donors.

EXAMPLE #1: In April of last year, the IRS improperly disclosed the Schedule B donor list on the Form 990 of the National Organization for Marriage, a 501(c)(4) issue group that advocates for traditional marriage between a man and a woman. While the Form 990 is publicly available, tax law and IRS regulations make clear that Schedule B donor list of the 990 is not to be released for (c)(3)s and (c)(4)s.

EXAMPLE #2: Last December, the IRS turned over several applications for non-profit status that included pending applications for tax-exempt status from a number of 501(c)(4)s to the group Pro Publica. While applications for non-profit status are available to the public after an official exemption is granted, they are protected tax return information while the application is pending.

As I understand it, publishing unauthorized tax returns or return information is a felony punishable by up to 5 years in prison or a fine of up to $5,000, or both. Despite this, Pro Publica published information from these pending applications that it should never have received. I have not been able to confirm that appropriate administrative or legal responses have been undertaken by the IRS and the Treasury.

EXAMPLE #3: Earlier this year in another allegedly "inadvertent" disclosure the IRS released to a another group, one page of the Schedule B showing donors to a 501(c)(4) affiliated with the Republican Governors Association.

These incidents are alarming because they show a breakdown in the safeguards surrounding confidential taxpayer information that has yet to be addressed.

I am concerned about the lack of progress on the parts of the IRS, the Treasury Department and the Justice Department in pursuing the apparent breakdown in taxpayer protection. We can all agree that tax return information should not be used for political gain, regardless of the political leanings of both the taxpayer and the tax administrator.

Secretary Lew and Acting Commissioner Miller, can you confirm that there is an active effort on the parts of both the IRS and the Department of the Treasury to find the sources of these releases?

Has the Department of the Treasury and the IRS identified other instances of Schedule B donor lists being improperly released to other parties? Please list any and all instances in your response.

Will you both commit to conducting a full investigation to identify the IRS sources responsible for these improper disclosures of protected taxpayer information and ascertain for what purpose that information was released in the first place?

Will you yourselves fully cooperate and direct your subordinates to fully cooperate with any such investigation?

As part of this investigation, will you give this subcommittee access to all materials related to the means and motives surrounding these disclosures and specifically investigate fully whether these disclosures were the result of intentional acts by the employees involved?

Will you submit the findings of this investigation to the Justice Department to take action and prosecute groups that knowingly published protected taxpayer information that they improperly received.

What concrete steps will you take to ensure that these apparent lapses in the protection of taxpayer information cease?

Will the Secretary and the Acting Commissioner confirm that they will not permit the IRS to politicize protected taxpayer information, regardless of the political nature of the information?

Answer. In response to questions at recent hearings, the IRS has stated that it is aware that the Treasury Inspector General for Tax Administration (TIGTA) was looking into the matters described in the examples above. It is our understanding that TIGTA did not find evidence that the disclosures in example one or two were willful or intentional. We have no information as to the status of example three. It is our understanding that TIGTA did not find evidence that either disclosure was willful or intentional. We defer to TIGTA for any additional information regarding their investigations. The IRS has taken steps to modify its processes, where necessary, to protect against these types of inadvertent disclosures. The IRS is currently engaged in another process review to determine whether additional modifications from an efficiency or taxpayer data protection perspective can be made.

Further, as a general matter, the IRS cannot comment on a specific release of taxpayer information nor on any specific investigation surrounding a potential release of taxpayer return information or other categories of protected information. The procedures regarding the release of such categories of taxpayer information are governed by the Freedom of Information Act (FOIA) process and the confidentiality and disclosure provisions of 26 U.S.C. 6103. The IRS is committed to following these procedures rigorously. It is absolutely inappropriate for the IRS to politicize protected taxpayer information, and we would see it as a violation of the IRS mission statement, which requires us to enforce the law with integrity and fairness to all.

Employees are required and trained to report within one hour of becoming aware of a potential inadvertent disclosure, loss or theft of sensitive information. They report first to their manager and then to one of the following offices depending on what was disclosed:

—to the Office of Taxpayer Correspondence (OTC), formerly Notice Gatekeeper, if the disclosure involves information released through correspondence to a taxpayer including in any of the following formats: notices, letters, transcripts, faxes, and other electronic transmissions such as e-mail;

—to the IRS Situation Awareness Management Center (SAMC), if the incident does not involve taxpayer correspondence, e.g., a verbal disclosure, or if the incident involves the loss, theft, or release of sensitive information, e.g., hardcopy records or documents, packages lost during shipment, etc., or a non-IRS IT asset, i.e., an IT asset in the Bring Your Own Device (BYOD) program or an IRS Contractor asset that has IRS data; or

—to the Computer Security Incident Response Center (CSIRC), if the incident involves the loss or theft of an IRS IT asset, e.g., an IRS issued computer, laptop, router, printer, removable media, CD/DVD, flash drive, floppy, cell phones, BlackBerry, etc.

In addition, if management determines that an unauthorized disclosure may be willful, it is referred to the Treasury Inspector General for Tax Administration (TIGTA) for investigation. Unlike inadvertent disclosures, a *willful* disclosure of IRS sensitive tax payer information is a violation of section 6103 and as such considered illegal. If TIGTA concludes there is evidence of wrongdoing, then TIGTA would refer the case to the Department of Justice for prosecution/penalties under 26 U.S.C. section 7213. In the situations outlined above, TIGTA concluded that the disclosures were inadvertent.

Treasury's longstanding practice, spanning administrations of both political parties, is not to be involved in the details of tax administration and enforcement. This is especially true with regard to individual taxpayers. Several independent reviews, including multiple investigations by Congressional Committees, are ongoing. Treasury is cooperating with these reviews.

QUESTIONS SUBMITTED TO HON. J. RUSSELL GEORGE

QUESTIONS SUBMITTED BY SENATOR FRANK R. LAUTENBERG

Question. Identity theft is a serious and growing problem in the United States and a daunting challenge for the IRS. Taxpayers are harmed when identity thieves file fraudulent tax documents using stolen names and Social Security numbers, and wrongfully receive refunds. Identity theft can be devastating for victims, whose legitimate refunds are blocked, forcing them to spend months untangling their account problems with the IRS.

Do you consider IRS's current strategy for dealing with identity theft and refund fraud to be adequate?

Answer. No. Although the IRS continues to improve its identity theft and refund fraud detection efforts, additional actions are needed.

In July 2012, we reported that the Tax Year (TY) 2010 tax returns processed during the 2011 filing season identified that tax fraud by individuals filing fictitious tax returns with false income and withholding is significantly larger than what the IRS detects and prevents. In addition, in May 2012, we reported that the IRS is not effectively providing assistance to taxpayers who report that they have been victims of identity theft, resulting in increased burden for these victims. Moreover, identity theft cases can take more than 1 year to resolve and communication between the IRS and victims is limited and confusing.

TIGTA has also continued to report significant concerns with the growth in noncompliance and fraud in refundable tax credits. The IRS does not have effective processes to ensure that claimants qualify for the Earned Income Tax Credit (EITC) at the time tax returns are processed and prior to issuance of fraudulent tax refunds. In addition, the IRS has made little improvement in reducing EITC improper payments in the years since it was required to report estimates of these payments to Congress in Calendar Year 2002. The IRS estimates that the EITC improper payment rate was 21–25 percent in fiscal year 2012, which equates to $12 billion to $14 billion.

The IRS continues to expand its efforts to prevent the payment of fraudulent tax refunds by processing all individual tax returns through identity-theft screening filters. These filters look for known characteristics of identity-theft cases to detect false tax returns before they are processed and before any fraudulent tax refunds are issued. However, without third-party income and withholding information, the filters will not identify the majority of potentially fraudulent tax returns for taxpayers who do not have a filing requirement.

For the 2013 filing season, the IRS indicates that for e-filed tax returns using the Social Security Number of a deceased individual, the tax returns are rejected from processing. For paper tax returns, the IRS has prevented the issuance of approximately $2.4 million in fraudulent tax refunds as a result of a program to lock taxpayers' accounts when there is a date of death. The IRS does not yet have similar information for e-filed tax returns; however, we are reviewing this in our current audit.

TIGTA made numerous recommendations for the IRS to develop or improve processes that will increase the IRS's ability to detect and prevent the issuance of fraudulent tax refunds resulting from identity theft. These include coordinating with responsible Federal agencies and banking institutions to develop a process to ensure that tax refunds issued via direct deposit to either a bank account or a debit card account are made only to an account in the taxpayer's name. In addition, the IRS should limit the number of tax refunds issued via direct deposit to the same bank account or debit card account, and work with the Department of the Treasury to ensure financial institutions and debit card administration companies authenticate the identity of individuals purchasing a debit card.

TIGTA's recommendations to improve the IRS's ability to detect and prevent the issuance of fraudulent tax refunds from erroneous claims for refundable credits include implementing an account indicator to identify taxpayers who claim erroneous refundable credits. Taxpayers with such an indicator should be required to provide documentation before their claims for refundable credits are processed. The IRS should also freeze and verify claims for the Additional Child Tax Credit on all returns for which the EITC is frozen. Furthermore, the IRS should work with the Department of the Treasury's Office of Tax Policy to seek legislation to expand the EITC due diligence requirements and penalties to include the Additional Child Tax Credit.

Question. What measures should the IRS pursue with greater vigor to improve its response to the growing problem of refund fraud and identity theft?

Answer. An important tool that could immediately help the IRS prevent identity theft-related tax fraud is the National Directory of New Hires. However, legislation is needed to expand the IRS's authority to access the National Directory of New Hires wage information for use in identifying tax fraud. Currently, the IRS's use of this information is limited by law to just those tax returns with a claim for the Earned Income Tax Credit. The IRS included a request for expanded access in its annual budget submissions for fiscal years 2010–2013, and has once again included a request in its fiscal year 2014 budget submission.

In addition, the IRS is developing a new Return Review Program system that will use leading-edge technologies to advance the IRS's effectiveness in detecting, addressing and preventing tax refund fraud, and protecting the U.S. Treasury revenue. It will replace the legacy Electronic Fraud Detection System built in the mid-1990s. The entirely new Return Review Program fraud framework is critical for IRS success in tackling ever-evolving tax schemes in a sophisticated, scalable and adaptable manner. We plan to issue a report by July 2013 that contains recommendations to improve the development of this system.

The IRS has a long-term initiative to move to a real-time tax system. The IRS's vision is to move away from an after-the-fact approach to compliance. A real-time tax system would allow the IRS to verify many tax return elements at the time a tax return is filed and allow taxpayers to correct potential discrepancies before the IRS completes the processing of their tax return. Of equal importance is that this type of tax system will allow the IRS to quickly identify fraudulent tax return filings based on false income reporting. The IRS is assessing its ability to use partial year wage and withholding information from employers and/or States, and whether the information would allow the IRS to better identify individuals filing fraudulent tax returns.

Question. Do you share the concern expressed by the National Taxpayer Advocate that victims still face the same "labyrinth of procedures and drawn-out timeframes for resolution" that they faced 5 years ago?

Answer. While we did not review the length of time to resolve identity theft cases 5 years ago, we reported in May 2012 that the IRS is not effectively providing assistance to identity theft victims.[1] Moreover, processes are not adequate to communicate identity theft procedures to taxpayers, resulting in increased burden for victims. Of continuing concern is the length of time taxpayers must work with the IRS to resolve identity theft cases. Identity theft cases can take more than 1 year to resolve. Communications between identity theft victims and the IRS are limited and confusing, and victims are asked multiple times to substantiate their identity. A typical identify theft refund case that is not overly complex will be resolved in approximately 11 months and will be handled by multiple IRS units. We plan to issue a report by September 2013 that evaluates whether the IRS has improved assistance to taxpayers.

Question. The IRS has significant responsibilities in implementing and administering the Affordable Care Act (ACA), including taxpayer education and outreach, deliverance of tax credits, and development of new Information Technology (IT) infrastructure to support all of these areas. TIGTA has identified "Implementing ACA" as a top management challenge for the IRS.

Based on TIGTA's audits and reviews, what are your chief concerns about the capacity of the IRS to meet its responsibilities for implementing and administering the various new responsibilities under the ACA given the IRS's budget constraints?

Answer. Several key ACA provisions will become effective in fiscal year 2014, therefore making fiscal year 2014 a significant year for ACA oversight. One key healthcare provision takes effect December 31, 2013. This provision is the requirement for individuals to maintain minimum essential health care coverage or face a continuous penalty. Starting in Calendar Year 2014, the IRS will be responsible for implementing the Premium Assistance Tax Credit as well as implementing the penalty on applicable individuals for each month they fail to have minimum essential coverage. This has far-reaching impact on the IRS, and will require significant resources, particularly customer service resources, as taxpayers turn to the IRS with questions and issues about the ACA and their tax and health insurance requirements. Later this year, we will be opening an audit of the IRS's administration of the Premium Tax Credit Project, which includes calculations necessary for designating ACA benefits.

We are also concerned that ACA-related work will continue to stretch the IRS's appropriated resources in the future. Beginning in fiscal year 2013, the IRS will no longer obtain any funding from the Health Insurance Reform Implementation Fund

[1] TIGTA, Ref. No. 2012–40–050, *Most Taxpayers Whose Identities Have Been Stolen to Commit Refund Fraud Do Not Recieve Quality Customer Service* (May 2013).

(Fund) for ACA-related work. The Fund is administered by the Department of Health and Human Services as provided for in the Health Care and Education Reconciliation Act of 2010 to carry out the ACA. In fiscal year 2012, the IRS received $299 million from the Fund to support an additional 664 Full-Time Equivalents. This was in addition to the funding received by the IRS based on its enacted budget. The IRS informed TIGTA that it does not anticipate receiving any funding from the Fund after fiscal year 2012. According to the IRS, its fiscal year 2013 spending plan includes $360 million to implement the ACA in fiscal year 2013. Since the IRS will not be reimbursed from the Fund for 2013, all fiscal year 2013 ACA spending is funded from the IRS's operating budget.

The IRS's fiscal year 2014 budget request includes a request for additional funding of $440 million to provide 1,954 Full-Time Equivalents for continued efforts related to the implementation of the ACA. The largest component of this increase is $306 million for the implementation of the information technology changes needed to deliver tax credits and other requirements.

Customer service has been declining in recent years, with fewer taxpayers being served at local offices and the IRS answering fewer telephone calls. The ACA will further stretch these already limited resources at the IRS. We recently began a review of the IRS's efforts to evaluate the IRS's customer service planning efforts to provide individuals assistance relating to ACA provisions on obtaining minimum essential health insurance coverage and tax credits to offset health care expenses. We plan to issue our report later in Calendar Year 2013.

TIGTA's fiscal year 2013 audit plan includes other ACA-related reviews that address Information Technology (IT) risks, including new systems development as required to meet IRS responsibilities under the ACA legislation.

TIGTA is also coordinating with the Health and Human Services Office of the Inspector General to consider the status and risk management for IRS systems and the requirements and results for interagency testing processes.

TIGTA plans to evaluate other IT risk areas for new ACA systems, including:

—a review of the IRS's Internet portal, which will support transactions generated by ACA systems; and

—an assessment of the impact of ACA business requirements on the IRS's IT systems and control environment.

Question. What constructive recommendations can TIGTA offer to the IRS to address the challenges it faces in implementing the ACA?

Answer. TIGTA has completed 10 ACA-related audits. Attached is a summary of these audits, including the recommendations made and the IRS's response to those recommendations.

(ATTACHMENT)

Treasury Inspector General for Tax Administration
Completed Affordable Care Act Audits

Reference Number: 2013–23–034, *Affordable Care Act: The Income and Family Size Verification Project: Improvements Could Strengthen the Internal Revenue Service's New Systems Development Process* (March 2013).

This audit was initiated to determine whether the Internal Revenue Service (IRS) adequately managed systems development risk for the Income and Family Verification System (IFVS) Project. This review addresses the major management challenge of Implementing Health Care and Other Tax Law Changes. The overall objective was to evaluate the IRS's progress in establishing controls to determine whether tax exempt hospitals comply with select provisions of the Affordable Care Act (ACA).

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

By the end of August 2012, the IFSV Project had completed all six systems development components. While cost data specific to the IFSV Project were not readily available during this audit, the IRS is generally managing systems development risk areas with the implementation of the new Iterative Path within the Enterprise Life Cycle.

However, process improvements are needed to better ensure that:

—the IFSV Project team adheres to configuration management guidelines when baselined requirements are changed; and

—the ACA Program Configuration Control Board emergency meeting processes are effectively communicated.

Further, an integrated suite of automated tools could improve requirements management and testing for the IFSV Project.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

The Treasury Inspector General for Tax Administration (TIGTA) recommended that the Chief Technical Officer complete a broader review to evaluate the effectiveness of existing controls to ensure that change requests and impact assessments are adequately developed and processed as required by the ACA Program Configuration Management guidelines. The Chief Technology Officer should also ensure that the ACA Program Configuration Management Plan is updated to include procedures to request and convene emergency ACA program Configuration Control Board meetings when timely program-level responses are needed. In addition, the Chief Technology Officer should ensure a standard suite of integrated, automated tools is implemented for the ACA Program and ACA projects to manage sprint processes, develop and manage requirements, develop and manage test cases, and bidirectionally trace requirements and test cases.

In response to our report, IRS management agreed with two of our three recommendations. However, the IRS disagreed with our recommendation to implement a standard suite of integrated, automated tools for the ACA Program and ACA projects.

Reference Number: 2013–43–033, *Affordable Care Act: Implementation of Key Information Reporting Provisions* (March 2013).

This audit was initiated as part of TIGTA's efforts to evaluate the IRS's plans for implementing the various ACA tax provisions. This review addresses the major management challenge of Implementing Health Care and Other Tax Law Changes. The overall objective was to determine whether the IRS is effectively implementing select ACA reporting requirements.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

The IRS continues to make progress in implementing the information reporting requirements relating to Provisions 1502, 1514, 9002, and 9010 of the ACA. However, the implementation of Provision 9002 that requires the inclusion of employer health coverage on Form W–2, *Wage and Tax Statement,* does not address how the IRS will use the information and how the IRS will ensure employer compliance with this information reporting requirement.

Many of the tax provisions included in the ACA are interrelated. As such, planning efforts should identify the relationships among the various tax and information reporting provisions. The IRS must ensure that all information needed to accurately and effectively administer these provisions is provided by employers, insurers, and taxpayers. In addition, creating separate implementation plans and assigning responsibility to different IRS offices may result in the IRS not evaluating these provisions collectively to ensure that it is requesting all the information needed to effectively verify employer, insurance provider, and individual compliance with the ACA.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA recommended that the IRS update the implementation plan for Provision 9002 to identify the actions needed to verify that employers are accurately reporting the total dollar value of health insurance coverage provided to an employee. The IRS should also ensure that all information necessary to maximize the IRS's ability to verify compliance with other tax-related provisions within the ACA is requested from third parties and processes are developed to use the information effectively.

In response to our report, the IRS agreed with our recommendations. IRS officials stated that the IRS has updated the Compliance Plan for Provision 9002 to include steps for verifying reporting compliance. The IRS also indicated that executive oversight by the Director, Affordable Care Office, and the Director, Implementation Oversight and Non-Exchange Provisions, ensures that the overall planning for all ACA provisions, including the ones affecting information reporting, is coordinated.

Reference Number: 2012–43–064, *Affordable Care Act: Planning Efforts for the Tax Provisions of the Patient Protection and Affordable Care Act Appear Adequate; However, the Resource Estimation Process Needs Improvement* (June 2012).

Our audit objective was to assess the Internal Revenue Service's (IRS) overall planning to implement the tax provisions of the new law.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

The ACA contains many provisions that are to be implemented over the course of several years, including some that required implementation during the year the legislation was signed into law. TIGTA found that appropriate plans had been developed to implement tax-related provisions of the ACA using well-established methods for implementing tax legislation. The IRS's plans addressed tax forms, instructions, and most of the affected publications, as well as employee training, outreach and guidance to taxpayers and preparers, computer programming, and data needs.

The IRS projected its fiscal years 2012 and 2013 ACA staffing needs to be 1,278 Full-Time Equivalents and 859 Full-Time Equivalents, respectively. The IRS has not projected staffing needs beyond fiscal year 2013. A lack of documentation to support the staffing requirements needed to implement the ACA precluded TIGTA from providing an opinion on the adequacy of staffing requests to support implementation. The IRS did not analyze each provision to determine the amount of staffing necessary to implement the provision.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA recommended that the IRS perform an analysis to evaluate the resources necessary to efficiently implement the provisions and ensure that this process is documented.

In their response to the report, IRS management agreed with the recommendation. The IRS plans to complete an evaluation by the end of fiscal year 2012 of the major ACA provisions for which implementation has not been completed and evaluate the resources needed for implementation, especially any with specialized skills.

Reference Number: 2012–40–065, *Processes to Address Erroneous Adoption Credits Result in Increased Taxpayer Burden and Credits Allowed to Nonqualifying Individuals* (June 2012).

This audit was initiated because, for tax years 2010 and 2011, the Adoption Credit became a refundable credit and the maximum credit amount was increased to $13,170 per adopted child for Tax Year 2010. The overall objective of this review was to assess the IRS's efforts to ensure the accuracy of Adoption Credit claims for tax returns filed from January 1 through August 6, 2011.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

The law did not provide and the IRS did not seek math error authority for Adoption Credit claims that did not include sufficient documentation. As a result, 43,295 (42.6 percent) of the 101,627 total Adoption Credit claims were referred to the IRS's Examination function because of incomplete or missing documentation. Math error authority would have allowed the IRS to spend approximately $1.9 million for other high-priority programs in the Examination function.

Our review also found that, as of August 6, 2011, the IRS processed 94,092 tax returns with an Adoption Credit claim and found that 4,258 (4.5 percent) taxpayers received almost $49.3 million in Adoption Credits without sufficient supporting documentation. Of these 4,258 taxpayers, TIGTA estimated that 953 tax returns claiming Adoption Credits totaling more than $11 million were erroneous.

In addition, TIGTA found that 333 taxpayers who had valid Adoption Credit claims totaling $2 million had their Credits incorrectly suspended and their tax returns were referred to the Examination function. These taxpayers had previously provided documentation when they applied for a Taxpayer Identification Number for a pending U.S. adoption.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA recommended that the IRS develop a process to prevent taxpayers from receiving the Adoption Credit when a foreign adoption is in process and to ensure that taxpayers identified as erroneously claiming the Adoption Credit are reviewed in the Examination function. The IRS should also ensure that computer programming accurately excludes tax returns that list Adoption Taxpayer Identification Numbers on Form 8839, *Qualified Adoption Expenses,* and indicate the adoption is in process so these taxpayers do not have their refunds erroneously suspended and delayed.

IRS management agreed and implemented corrective actions for all the recommendations. The corrective actions included changing processing procedures, updating instructions, and training employees to ensure erroneous adoption benefits are identified when a foreign adoption is in process. In addition, programming changes were implemented for the 2012 filing season to prevent refund delays when an Adoption Taxpayer Identification Number is used. Returns TIGTA identified for taxpayers who potentially received erroneous adoption credits were selected for examination, when warranted.

Reference Number: 2012–13–070, *Affordable Care Act: While Much Has Been Accomplished, the Extent of Additional Controls Needed to Implement Tax-Exempt Hospital Provisions Is Uncertain* (June 2012).

This audit was initiated as part of TIGTA's efforts to evaluate the IRS's plans for implementing the various ACA tax provisions. This review addresses the major management challenge of Implementing Health Care and Other Tax Law Changes. The overall objective was to evaluate the IRS's progress in establishing controls to determine whether tax exempt hospitals comply with select provisions of the ACA.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

The IRS has made progress establishing controls to determine whether tax-exempt hospitals comply with provisions of the ACA and has already opened reviews of the community benefit activities of approximately 1,700 healthcare organizations. However, it is difficult to determine at this point how much additional work will be required of the Exempt Organizations function to fully implement controls because legal guidance has not been published. This guidance, which is currently under review, would provide the Exempt Organizations function with a basis for identifying additional controls needed to determine whether tax exempt hospitals comply with the ACA.

In addition, the Department of the Treasury will be required in the near future to send its first annual report to Congress regarding tax-exempt hospitals. The IRS is responsible for working with the Department of Health and Human Services to gather the data for this report. While communication has been established, the format and timing of receipt of data have not been formalized.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA recommended that the Director, Exempt Organizations, work with the Department of the Treasury to establish a Memorandum of Understanding with the Department of Health and Human Services. The Memorandum of Understanding should take into consideration when information for the annual report to Congress should be received by the IRS and the proper format of the data to ensure it will be timely and usable for the report to Congress.

In response to our report, IRS management agreed with our recommendation. The IRS plans to work with the Department of the Treasury to establish a Memorandum of Understanding with the Department of Health and Human Services that takes into consideration when information for the annual report to Congress should be received and the proper format of the data to ensure it will be timely and usable for the report to Congress.

Reference Number: 2012–13–009, *Affordable Care Act: The Office of Appeals Planning Efforts for the Health Care Reform Legislation* (December 2011).

The overall objective of our audit was to determine how Appeals planned for the implementation of the health care legislation. This review is included in our fiscal year 2012 Annual Audit Plan and addresses the major management challenge of Implementing Major Tax Law Changes.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

After the ACA was enacted in March 2010, the IRS ACA Office determined that the impact on Appeals would be minimal until after Calendar Year 2013. Given this time period, Appeals management has taken some initial actions to begin preparing for the ACA legislation. Appeals personnel have been detailed to the IRS ACA Office and other IRS ACA teams on an ongoing basis to remain informed on how the IRS is preparing for the ACA and the potential impact of these efforts on Appeals. To lead its planning efforts, Appeals appointed a Senior Analyst in July 2011 to serve as the Appeals ACA Program Manager.

In addition, Appeals created an internal Web site with links to IRS ACA-related training, guidance, and other resources. Appeals management also informed TIGTA they are currently assessing how to code ACA cases on their inventory database to track the number of taxpayers and businesses that appeal the various health care provisions.

As Appeals moves forward with its planning efforts, TIGTA believes management should develop a more formal approach to its ACA planning activities to ensure they are ready to resolve taxpayer requests of ACA-related issues in a timely and effective manner. This should include outlining the key objectives/tasks that need to be addressed to prepare for the ACA-related impact on Appeals, who will be responsible for conducting these activities, and when these actions need to be completed over the next several years.

In addition, Appeals management should consider the type and frequency of communication between the Appeals internal working group, the IRS ACA Office, and other IRS operating divisions to ensure their planning efforts are coordinated as appropriate. This communication will assist Appeals management in staying informed of IRS actions to address the ACA provisions. Effective planning is critical to ensuring Appeals' readiness to prepare for this legislation and resolve taxpayer requests in a timely and effective manner.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA made no recommendations in this report. Appeals management reviewed the report before it was issued and offered clarifying comments and suggestions, which have been taken into account.

Reference Number: 2011–40–100, *Legislative Requirements Were Met When Awarding Credits and Grants for the Qualifying Therapeutic Discovery Project Program* (September 2011).

This audit was initiated to determine whether the QTDP Program met legislative requirements when considering and awarding credits and grants to qualifying therapeutic discovery project applicants, and whether the IRS implemented adequate controls to monitor the credits and grants.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

The IRS met legislative requirements when awarding credits and grants to QTDP Program recipients. Despite the unprecedented short time period allotted by the law for creating the QTDP Program, the IRS achieved its goal.

The IRS team administering the QTDP Program, in consultation with the Department of Health and Human Services, processed 5,663 Applications for Certification of Qualified Investments Eligible for Credits and Grants Under the Qualifying Therapeutic Discovery Project Program (Form 8942). Of the 5,663 Forms 8942 received, 4,606 (81.3 percent) were approved for a credit or grant.

All QTDP Program certified applicants were listed by State on IRS.gov, as required by law. The IRS has internally revised and corrected the number of entities receiving credits or grants, but it has not updated IRS.gov since November 1, 2010.

The IRS prepared numerous documents that record the process for implementing the QTDP Program. These documents will be helpful for implementing future unique and similar projects.

A compliance plan was developed and is being implemented. The plan includes reviewing the tax returns of taxpayers who accepted QTDP Program credits and grants. The IRS mailed 326 letters to grant recipients that had not yet filed an amended Tax Year 2009 tax return.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, ensure:

—the information regarding the applicant names and amounts allocated are updated on IRS.gov to accurately show which taxpayers and projects were originally awarded QTDP Program credits and grants; and

—the QTDP Program line item is removed from Investment Credit (Form 3468) after a determination is made that all QTDP Program taxpayers have filed their Tax Year 2010 returns.

The IRS agreed with the recommendations. The IRS plans to:

—update the information on IRS.gov regarding the applicant names and amounts allocated through July 31, 2011; and

—by July 15, 2012, make a final update to IRS.gov to reflect any activity from August 1, 2011, to the end of the QTDP Program. Concerning the second recommendation, the IRS has notified the Forms and Publications function of the need to remove the QTDP Program line from Form 3468 once it has determined that all QTDP Program taxpayers have filed their Tax Year 2010 returns.

Reference Number: 2011–40–115, *Affordable Care Act: The Number of Taxpayers Filing Tanning Excise Tax Returns Is Lower Than Expected* (September 2011).

The objective of our audit was to determine whether the Internal Revenue Service (IRS) effectively implemented this tax.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

The IRS developed an outreach plan, updated the excise tax form and instructions, and made preparations for receiving and processing tax returns with the tax. The IRS also developed a plan for dealing with noncompliance, including initiating audits and issuing notices to taxpayers who may potentially owe the tax.

The number of taxpayers filing tanning services excise tax returns is much lower than expected. According to IRS documents, in April 2010, the Indoor Tanning Association estimated that 25,000 businesses were providing indoor tanning services. However, the actual number of businesses liable for the tax has been difficult to determine with any degree of accuracy. Identifying these taxpayers has been one of the more challenging tasks the IRS has faced when implementing this provision. For the first three applicable quarters, the number of Federal excise tax forms reporting tanning taxes has averaged approximately 10,300.

The IRS could have taken more timely actions to contact taxpayers who may owe the tax. By the time notices were issued, tanning excise tax returns had been due for three quarters. Late filing of these returns would result in the taxpayer owing the unpaid tax, plus interest and penalties. In addition, the information used to identify these taxpayers appears incomplete. Furthermore, TIGTA advised the IRS that the notice did not contain some pertinent information. The IRS added this information before mailing.

Finally, the publication containing information about excise tax requirements was not updated until more than 1 year had passed since the provision became effective.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA recommended that the IRS perform further analyses of the data sources used, including records with incomplete address information, to determine whether a large number of tanning businesses were not identified, monitor the results from the notice mailing to determine whether additional data sources are warranted, and update the excise tax publication to include tanning tax information.

In their response to the report, IRS officials agreed with our recommendations. The IRS plans to perform the analysis suggested, monitor the results of the notice mailing, and consider additional actions based on the results. The excise tax publication was revised in July 2011 to include tanning tax information.

Reference Number: 2011–20–105, *The Modernization and Information Technology Services Organization Is Effectively Planning for the Implementation of the Affordable Care Act* (September 2011).

This audit was initiated to evaluate the Modernization and Information Technology Services organization's planning efforts to implement the Affordable Care Act.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

The Modernization and Information Technology Services organization planned an effective approach to address the information technology work needed to implement the Affordable Care Act provisions. For example, it determined the Affordable Care Act's impact on its organization, created a new organization called the Associate Chief Information Officer Affordable Care Act—Program Management Office, and obtained staffing and funding. A Program Governance Board Charter was approved and a governance plan was prepared. However, the governance plan did not include escalation procedures for unresolved issues or critical decisions.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA recommended that the Chief Technology Officer ensure that the Modernization and Information Technology Services organization's Affordable Care Act—Program Management Office governance plan is updated to include escalation procedures to timely address unresolved issues and critical decisions.

In their response to the report, IRS management agreed with the recommendation. The IRS plans to include the escalation procedures in the Affordable Care Act—Program Management Office governance plan.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION FOUND

The IRS timely completed actions to plan for and implement the Credit. The volume of claims for the Credit has been low despite IRS efforts to inform 4.4 million taxpayers who could potentially qualify for the Credit. According to the IRS, as of mid-May 2011, just more than 228,000 taxpayers had claimed the Credit for a total

Reference Number: 2011–40–103, *Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed* (September 2011).

This audit was initiated to determine whether the IRS adequately implemented and accurately processed the Credit. The Congressional Budget Office estimated the Credit would cost $37 billion over 10 years and that taxpayers would claim up to $2 billion of Credit for Tax Year 2010.

amount of more than $278 million. Among reasons given by industry groups and professional organizations for the low volume was the time and effort required to claim the Credit. The IRS plans to conduct focus groups to determine why the claim rate was so low.

The Credit is specifically targeted to small employers but certain taxpayers may claim the Credit even when they have not filed employment tax returns. This occurs because companies can enter into a contractual relationship with a Professional Employer Organization that manages human resources. As a result, the IRS cannot determine if employment taxes were actually filed.

The Credit for Small Employer Health Insurance Premiums (Form 8941) does not contain all of the data and calculations needed to verify each step of Credit eligibility and calculation. Based on the information that was available, TIGTA found that both taxpayers and tax practitioners were making mistakes when completing Form 8941. The IRS has not validated the calculations where possible, nor has it captured sufficient information from the Form 8941 to allow it to use computer checks to validate the calculations.

WHAT THE TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION RECOMMENDED

TIGTA recommended that the IRS track Professional Employer Organization relationships; seek legislation to provide targeted math error authority that would allow the IRS to disallow the Credit when employment tax returns have not been filed; until math error processes are established, consider implementing processing criteria that would route returns that are obviously wrong to the Examination function prior to completing processing; and ensure that all lines from the Form 8941 are transcribed onto IRS systems to allow more basic checks of arithmetic accuracy during processing.

In their response to the report, IRS officials agreed with the recommendations and plan to take appropriate corrective actions.

(END OF ATTACHMENT)

Question. Is the funding requested by the IRS sufficient to complete the systems development needed to have fully functioning systems in place when the new health insurance premium tax credits and other ACA provisions take effect in 2014?

Answer. Additional funding for ACA-related systems development has been requested each year; however, the IRS only received additional funding from the Health Insurance Reform Implementation Fund (Fund) in fiscal years 2010–2012 to implement the ACA. The IRS did not receive additional funding for ACA in fiscal year 2013. As a result, the IRS has had to use regular appropriated funds to fund ACA systems development.

In fiscal year 2010, the IRS received $21 million from the Fund; in fiscal year 2011, the IRS received $168 million; and in fiscal year 2012, the IRS received $299 million to support an additional 664 Full-Time Equivalents. The Fund is administered by the Department of Health and Human Services as provided for in the Health Care and Education Reconciliation Act of 2010 to carry out the ACA. This was in addition to the funding received by the IRS based on its enacted budget. The IRS informed TIGTA that its fiscal year 2013 spending plan includes $360 million to implement the ACA in fiscal year 2013. Since the IRS will not be reimbursed from the Fund for 2013, all fiscal year 2013 ACA spending is funded from the IRS's operating budget.

TIGTA reviewed the IRS's planning for the information technology impact of the ACA. The ACA will require the IRS to build eight new computer applications to implement ACA provisions. The IRS was authorized direct hire authority to hire up to 355 information technology personnel to support the ACA implementation. As of April 2011, 368 employees were assigned to ACA-related work within the IRS Information Technology organization: 255 in the Program Management Office and 113 in the Information Technology organization delivery partner organizations. The Program Management Office stated that the staffing as of April 2011 is adequate for the current workload. The Program Management Office plans to hire additional people as more projects are initiated and will reevaluate its staffing needs as it works with the IRS operating divisions to refine the business requirements.

The development and implementation of new systems for the ACA provisions present major information technology management challenges. These include rapid implementation of interdependent projects that require extensive coordination within the IRS and with other Federal agencies.

TIGTA's fiscal year 2013 audit plan includes other ACA-related reviews that address Information Technology (IT) risks, including new systems development as required to meet IRS responsibilities under the ACA legislation. We are currently auditing the Premium Tax Credit Project, which includes calculations necessary for designating ACA benefits.

TIGTA is also coordinating with the Health and Human Services Office of the Inspector General to consider the status and risk management for IRS systems and the requirements and results for interagency testing processes.

TIGTA plans to evaluate other IT risk areas for new ACA systems, including:

—a review of the IRS's Internet portal, which will support transactions generated by ACA systems; and

—an assessment of the impact of ACA business requirements on the IRS's IT systems and control environment.

Question. The "tax gap" is the difference between the estimated amount taxpayers owe and the amount voluntarily and timely paid. An estimated $450 billion of Federal taxes are unpaid each year, for a noncompliance rate of nearly 17 percent. TIGTA cites Tax Compliance as the second greatest management challenge facing the IRS. A significant amount of income remains unreported. Collecting unpaid taxes is an enormous untapped source of Federal revenue that could fund many worthy unmet national needs.

What are your views on the adequacy of the IRS's strategy to narrow the tax gap?

Answer. The IRS and Treasury strategy to narrow the Tax Gap is a multi-faceted approach that encompasses virtually every aspect of tax administration. It is uncertain whether or not the strategy will lead to long-term success in reducing the Tax Gap. The strategy was developed in 2007 and is predicated on increased funding for compliance resources, legislative changes, increased information reporting and a successful Business Systems Modernization. This includes improving customer service to allow the IRS to migrate more customer service interactions from phones and walk-in sites to automated self-service options; implementing third-party information reporting programs through matching Form 1099–K information with businesses' reported income; enhancing domestic and international tax enforcement activities through programs such as the Offshore Voluntary Disclosure Program; and, working to propose and enact legislative proposals to increase tax compliance. Fewer resources will reduce the abilities of the IRS to implement these initiatives.

Question. What impediments must the IRS address to be more effective in narrowing the tax gap?

Answer. The IRS will be challenged to close the Tax Gap with fewer resources. The IRS will need to look to other methods to address the different types and causes of noncompliance. Specifically, enhanced information reporting by third parties, modernized information systems, penalty assessments, and increased leveraging of external resources, such as paid tax return preparers and whistleblowers, can help improve tax compliance.

Tax Gap reduction is an incremental effort to increase voluntary compliance and is an ongoing process. The way to attack the Tax Gap in an austere environment is to continue to build organizational capability and capacity. At the same time, simplifying the tax law and increasing the visibility of transactions through information reporting would help the IRS to identify noncompliance at less cost.

In addition, the Foreign Account Tax Compliance Act (FATCA) is an important development in U.S. efforts to improve tax compliance involving foreign financial assets and offshore accounts which, if successful, could help to reduce the Tax Gap.

Question. What is the effect of declining resources on the IRS's ability to meaningfully address the tax gap through new compliance and enforcement initiatives?

Answer. Due to resource limitations, the IRS is not able to devote additional resources to enforcement that would enable it to contact the millions of potentially noncompliant taxpayers it identifies. The Acting IRS Commissioner (Steven T. Miller) testified on May 8, 2013 that the budget cuts in the past few years could result in a steady erosion in the service the IRS provides to taxpayers and in the amount of money it collects through enforcement activities.

To determine the appropriate level of enforcement resources, policymakers would need to consider how to balance taxpayer service and enforcement activities with other priority programs such as identity theft and the ACA. Another consideration would be how effectively and efficiently the IRS currently uses its resources. TIGTA has reported that the IRS should pursue alternative audit selection techniques by using existing databases containing partnership data to help identify additional productive returns for audit. In addition, TIGTA plans to review the development of a new Foreign Accounts Tax Compliance Act system once implemented that is critical for the IRS to ensure international tax compliance.

Notwithstanding resource limitations, the IRS can use several different methods to address the different types and causes of non-compliance attributed to the Tax Gap, such as enhancing information reporting by third parties; ensuring high-quality services to taxpayers; expanding compliance checks before the IRS issues refunds; leveraging external resources, such as paid tax return preparers and whistleblowers; modernizing information systems; simplifying tax return requirements; increasing the use of penalty provisions to deter noncompliance; and using the IRS's National Research Project data to better target examinations on areas of noncompliance.

Question. How important are sustained resources for increased information reporting to narrowing the tax gap?

Answer. For individual tax returns, increased third-party information reporting of wages and withholding is the single most important tool in detecting and stopping fraudulent tax refunds before they are issued. For international tax compliance, information reporting by foreign financial institutions under the Foreign Account Tax Compliance Act is an important development in U.S. efforts to improve tax compliance involving foreign financial assets and offshore accounts which, if successful, could help to reduce the Tax Gap. For business taxpayers, implementing third-party information reporting programs through matching Form 1099–K information with businesses' reported income will assist the IRS in improving business tax compliance. However, fewer resources, and other competing priorities such as ACA-related work and identity theft, will reduce the abilities of the IRS to implement these initiatives.

Question. What additional oversight does TIGTA recommend to ensure that information obtained from voluntary disclosures is accurate and complete to better identify additional taxpayers and promoters who continue to defraud the U.S. through offshore activities?

Answer. In September 2011, we reported that the IRS's voluntary disclosure practices were effective, and cases were being appropriately assigned and verified even with the unusually high volume of disclosure requests received and accepted. However, our review of closed voluntary disclosure cases showed that not all cases had evidence of the taxpayers reconciling the unreported income in their offshore accounts to their amended or newly filed delinquent tax returns. In some cases, information from the taxpayers' financial accounts and promoters either was not captured or was incorrectly transcribed on the data collection system used for current and subsequent data mining efforts.

We made several recommendations and the IRS agreed to implement a requirement for taxpayers to provide a detailed reconciliation of unreported income and to develop a quality review process to ensure all data relating to voluntary disclosures are properly transcribed for future data mining.

QUESTIONS SUBMITTED BY SENATOR MIKE JOHANNS

Question. According to reports, Treasury Department officials were notified of the audit related to the use of inappropriate criteria to identify tax-exempt applications for review on more than one occasion. Please list the names and positions of all of the individuals notified directly by the Treasury Inspector General for Tax Administration (TIGTA) and the dates on which they were notified or this audit was referenced or discussed.

Answer.—

—June 4, 2012—J. Russell George briefed Chris Meade about the new audit, who was the Treasury's Deputy General Counsel at that time.

—Mid-summer 2012 (Approximately July)—J. Russell George briefed the Treasury Deputy Secretary Neal Wolin about the audit.

—March 15, 2013—J. Russell George met with Secretary Jacob Lew and briefed him on the audit.

Question. Did TIGTA ever notify Treasury Secretary Timothy Geithner regarding this audit?

Answer. To the best of his recollection and per his calendar schedule, J. Russell George did not.

Question. Did TIGTA notify any Treasury Department officials who reported to Secretary Geithner about this audit? If so, please list the names and positions of these individuals.

Answer. Please see our answer to the first question. It is not known whether the individuals TIGTA briefed reported any information about the audit to Secretary Geithner. J. Russell George briefed Deputy General Counsel Christopher Meade on June 4, 2012. According to Treasury Order 101–5, the General Counsel reports directly to the Deputy Secretary; therefore, we do not know if Mr. Meade briefed Secretary Geithner directly.

Question. When was Secretary Lew first notified by TIGTA about this audit?

Answer. J. Russell George met with Secretary Jacob Lew on March 15, 2013.

Question. Did TIGTA ever directly notify persons within the White House of the audit or have discussions with the White House about the audit?

Answer. No. J. Russell George did not directly notify or have discussions with any persons within the White House about the audit.

Question. Had the TIGTA issued the final report on this audit when the Interal Revenue Service (IRS) made the issue public at the ABA meeting on May 10, 2013?

Answer. No. We issued the final report on May 14, 2013. A redacted final report was posted on our public Website later in the evening on May 14, 2013.

Question. Has the IRS ever before publicly disclosed information about a TIGTA audit or investigation prior to TIGTA's issuance of its final report?

Answer. To the best of our recollection, we do not remember an instance when the IRS publicly disclosed information regarding the findings of an audit report prior to it being issued as a final report.

Question. Is TIGTA currently engaged in any other audits related to the management of the IRS?

Answer. Yes, we publicly released a report on IRS conference spending on June 4, 2013.

We also have audits and an inspection review on the following management oversight areas at the IRS:

—Purchase card transactions;
—Executive travel;
—Vendor payment controls;
—Validating return on investment for enforcement initiatives;
—Contractor employee eligibility;
—Affordable Care Act—Use of the health insurance reform implementation fund;
—Socioeconomic contracting;
—Efforts to detect and prevent identity theft;
—Issuance of employer identification numbers;
—Return review program; and
—Awards.

These audits are in various stages of the audit and final reports have not been issued. As a result, for most of the audits, we do not know whether there are management oversight concerns that would be of interest to the subcommittee. We would be willing to brief the subcommittee after we issue the final reports to the IRS and before the reports are publicly released.

SUBCOMMITTEE RECESS

Senator UDALL. This subcommittee stands recessed.

[Whereupon, at 4:39 p.m., Wednesday, May 8, the subcommittee was recessed, to reconvene subject to the call of the Chair.]