

FINANCIAL SERVICES AND GENERAL
GOVERNMENT APPROPRIATIONS FOR 2016

HEARINGS
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON APPROPRIATIONS
HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTEENTH CONGRESS
FIRST SESSION

SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
APPROPRIATIONS

ANDER CRENSHAW, Florida, *Chairman*

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NOTE: Under Committee Rules, Mr. Rogers, as Chairman of the Full Committee, and Mrs. Lowey, as Ranking Minority Member of the Full Committee, are authorized to sit as Members of all Subcommittees.

WINNIE CHANG, KELLY HITCHCOCK,
ARIANA SARAR, and AMY CUSHING,
Subcommittee Staff

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PART 5—FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2016

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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2016

WEDNESDAY, FEBRUARY 25, 2015.

INTERNAL REVENUE SERVICE—OVERSIGHT

WITNESSES

**HON. J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION, DEPARTMENT OF THE TREASURY**

**NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE, INTERNAL REV-
ENUE SERVICE**

Mr. CRENSHAW. Well, it is 10 o'clock, and we will start the meeting. I want to say good morning to everyone. The hearing will come to order.

Today's hearing is the first of the year for our subcommittee. I want to welcome all returning subcommittee members. We appreciate all of your hard work. A warm welcome to a couple of new members. They are in another hearing, but they will be along in a little bit.

Today this subcommittee is going to hear about activities and operations of the IRS from the Treasury Inspector General for Tax Administration, J. Russell George, and the National Taxpayer Advocate, Nina Olson. We appreciate their willingness to share their expertise with us again and to appear before the subcommittee exactly 364 days since they were here last time.

As a matter of housekeeping for the members, we will follow the 5-minute rule during the question-and-answer period. I do not plan on cutting anybody off in the middle of their sentence. But if everyone could keep their comments and questions to about 5 minutes, that would be appreciated.

We will recognize the members in order of seniority based on who was seated at the beginning of the hearing, going back and forth between the parties, and latecomers will be recognized in the order that they arrive, going back and forth.

Now, last year was a good year for this subcommittee. It was the first time since 2008 that the subcommittee's bill was brought to the House floor under open rule. And that is thanks to the leadership of Mr. Rogers, the chairman of the full committee.

And we do not know when the Budget Committee will complete its work on the budget resolution, but both the House and the Senate Appropriations full committee chairmen have said they intend to bring all 12 bills to the floor this year under regular order.

And, by that, I mean the process by which appropriations bills that reflect our funding priorities are marked up. They are subject

to amendment in the committee and on the House floor, and then they will be conferenced with the other chamber.

And for the first time since 2010 the Administration submitted its budget request on time in accordance with the Congressional Budget Act on the first Monday of February. While timeliness is always appreciated, a budget that spends more, taxes more, and borrows more is not.

Within the President's request is a massive \$2 billion, or 18 percent, increase for the IRS. Earlier this month the IRS Commissioner told the Senate Finance Committee that the IRS was not asking for an increase. No. They were just asking for the money that was taken away.

Well, if the Commissioner believes that the IRS is just automatically entitled to \$13 billion, I think he is making a mistake, because entitlements are for programs like Social Security, Medicare, and Medicaid. Providing for the national defense is a Constitutional obligation, but even the Department of Defense has to come in and appear before the Appropriations Committee.

They have to justify and defend their requests. They have got to provide reports and briefings and subject themselves to Congressional oversight hearings before Congress and that is before we provide them any funds. So the IRS will have to do the same thing.

I think we all want the IRS to answer the phone most of the time. We want them to prepare forms and instructions. We want them to process returns and process refunds. We want them to pursue criminals and tax cheats.

But I also think we all want the IRS to administer the Tax Code in a fair and objective manner. We want them to respect the Constitutional rights of taxpayers. We want them to safeguard taxpayers from identity theft. We want them to be a good steward of the funds that are provided by this Congress.

And while the IRS has exhibited a litany of questionable practices and expenses over the past 5 years with regard to processing tax exempt applications, bonuses, conferences, videos, and now hiring, what I really want to hear today from you all is how the IRS has or could change its ways.

After 5 years of budget cuts or freezes, I would hope that the IRS has turned over a new leaf, studying its budget line by line, identifying its highest priorities, reengineering its business practices, and concentrating its resources, both people and money, on what matters most.

For example, the Commissioner frequently complains about the audit rate going down. But my question is: Could the IRS do a better job of selecting which cases to audit and which ones not to audit? Has the IRS refined its selection criteria to reduce the rate of false positives, cases that are selected for audit, but do not result in tax liability? Why expend limited resources and burden taxpayers if they are ultimately found to be tax-compliant?

We deliberately lowered the IRS funding to a level to make them think twice about what they are doing and why they are doing it. They do not have a dime to spare on anything frivolous or foolhardy or mediocre. The IRS should and must focus on the most important and most egregious and the most in need.

So, again, we welcome General George and Ms. Olson. We look forward to your testimony and working with you on improving the IRS.

And now I would like to turn to my ranking member, Mr. Serrano. I thank him for all the work that he has done last year as we worked together. We didn't always agree, but we brought a bill to the floor. And I appreciate his efforts and insights.

And so I would like to yield to you for any opening statement you might like to make.

Mr. SERRANO. Thank you, Mr. Chairman.

And on that note, I just want to say that, had it not been for that last airdrop from the Senate on our bill, you might have seen a different behavior on our side on our bill, which would have been historic in recent times. But, nevertheless, I appreciate the work.

We also have, besides Mr. Quigley, Mr. Fattah and Mr. Bishop; Fattah and Bishop being new members of the subcommittee who will be here sometime during the hearing.

Thank you, Mr. Chairman. I would also like to welcome the Department of the Treasury Inspector General for Tax Administration, J. Russell George, and National Taxpayer Advocate, Nina Olson, back to the committee. I know you all are very busy; so, I thank you for making the time to be here today.

The IRS ensures the collection of taxes and provides taxpayer services. Approximately \$3 trillion in Federal revenue is collected by the agency each year. The agency employs a staff of around 100,000. These individuals help millions of Americans who file their taxes, process 237 million tax returns, and conduct tax audits and investigations.

Without the work of the IRS staff, the Federal Government would not be able to function, since they collect the vast majority of the revenue that allows that to happen. As many of us are aware, the IRS has implemented the recommendations of the Treasury Inspector General for Tax Administration to remedy problems resulting from the inappropriate targeting of liberal and conservative 501(c)(4) entities.

I applaud the agency's undertaking to implement reforms and prevent problems from repeating. With that being said, there are many challenges that the IRS is currently facing. The IRS has been severely underfunded for several years due to budget cuts made by this committee, which I strongly oppose. These budget cuts have made it difficult for the agency to hire and maintain personnel who are essential to carrying out taxpayer services and enforcement and who are the ones who are charged with fixing the problems at IRS.

As a result of understaffing, the IRS is anticipating that, in fiscal year 2015, it will only be able to answer around 50 percent of the calls they receive from taxpayers seeking assistance. That percentage goes up or down, depending on when they release seasonal workers. That is a 57 percent decrease from the level the agency was able to function at over a decade ago in 2004.

The IRS also anticipates being unable to collect \$2 billion in taxes owed to our Nation's Government as a result of these cuts. I hope we will get a chance today to discuss the impact of these cuts in your eyes.

The current operating budget is at its lowest since fiscal year 2008 and the lowest funding level since 1998. When adjusted for inflation, since then, the number of filers has increased by 22 percent. New tax responsibilities set forth by the Affordable Care Act and the Foreign Account Tax Compliance Act passed by Congress are adding to the IRS's growing workload.

The President's fiscal year 2016 request recognizes the need to provide the agency with a workable budget by requesting more than \$1.3 billion over fiscal year 2015. I hope this subcommittee will take that request seriously. We, as lawmakers and as members of this subcommittee, are charged with the task of ensuring that the IRS is able to do its job effectively. And, as a result of these cuts, they increasingly cannot.

I am also concerned with the problems families who claim the earned income tax credit, or EITC, face. EITC is a successful national anti-poverty program that helps low-income families obtain much needed financial support. These families make up a large percentage of the IRS audits due to unintentional errors and not fraud. This is mostly attributed to the complexity of the EITC rules and to errors made by commercial preparers. The IRS should implement several changes in order to reduce the EITC error rate and has made some good steps in this process.

As I stated before, cutting the IRS budget will hinder any progress that has been made. I hope that we can assure that the IRS maintains a reasonable budget and is able to make sure that taxpayer programs like the EITC are able to fulfill their mission. I look forward to discussing these and other issues with you today.

And I thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you, Mr. Serrano.

Now we will turn to General George for your testimony. If you could keep it in the neighborhood of 5 minutes, it will allow us time for questions. The floor is yours.

Mr. GEORGE. Thank you, Chairman Crenshaw, Ranking Member Serrano, members of the subcommittee. Thank you for the invitation to discuss ways for the Internal Revenue Service to perform its mission more efficiently and effectively.

We have reported that a trend of lower budgets and reduced staffing has affected the IRS's ability to deliver its priority program areas, including customer service and enforcement. In addition, it has the increased responsibilities of implementing certain provisions of the Affordable Care Act.

The IRS also continues to dedicate significant resources to detect and review potential identity theft tax returns and assist victims. IRS employees who work the majority of identity theft cases are telephone assisters who also respond to taxpayer calls to the IRS's toll-free telephone lines. This has contributed to the IRS's inability to timely resolve victims' cases as well as the continued decline in its ability to timely respond to taxpayers' written correspondence.

While the IRS faces many resource challenges, TIGTA has recently reported on several areas where the IRS can operate more efficiently. For example, we determined that electronic filing of amended tax returns could save the IRS money and prevent the issuance of erroneous tax refunds.

We believe the IRS could save about \$17 million per year if it allowed taxpayers to electronically file amended tax returns rather than only allowing paper returns. Electronic filing of amended returns would also enable the IRS to use the processes it currently uses to verify originally filed tax returns.

TIGTA estimates that using these same processes could prevent the issuance of more than \$2 billion in potentially erroneous refunds associated with amended returns over the next 5 years.

TIGTA also found that the IRS's field work collection process is not designed to ensure that cases with the highest collection potential are identified. With the significant growth in delinquent accounts and the reduction in the number of IRS employees, it is essential that cases with the highest risk and potential for collection are identified.

The IRS could also make more informed business decisions when determining how to use its limited resources. For example, the IRS eliminated or reduced services at Taxpayer Assistance Centers. Although the IRS stated that the services eliminated or reduced were, in part, the result of the IRS's anticipated budget cuts, the IRS's plans did not show the extent of how the reduction in services would lower costs. Moreover, it later had to reverse certain decisions.

Furthermore, timelier reporting of third-party data and additional authority would assist the IRS in improving tax administration. Each year, the IRS receives information returns filed by third parties, such as employers and educational institutions.

These returns provide the IRS the information needed to verify taxpayers' claims for benefits, such as the Earned Income Tax Credit and the American Opportunity Tax Credit. However, information returns are generally not filed with the IRS until after most taxpayers have filed their annual tax returns.

Requiring third parties to file information returns earlier would provide the IRS the opportunity to use the information contained in these forms to verify tax returns at the time they are processed rather than after refunds are issued.

For example, the IRS issued more than \$3 billion in potentially erroneous education credits in Tax Year 2012 to taxpayers who claimed students for whom the IRS did not receive a Form 1098-T tuition statement from a post-secondary educational institution. However, even if the third-party information returns are received more timely, the IRS still needs certain authorities to more efficiently and effectively use this data.

Generally, the IRS must audit any tax return it identifies with a questionable claim before the claim can be adjusted or denied, even if the IRS has reliable data that indicates the claim is erroneous.

The Department of the Treasury has included a legislative proposal as part of the IRS's budget requests since Fiscal Year 2013 to obtain correctable error authority, which would permit the IRS to systematically deny all tax claims for which the IRS has reliable data showing the claim is erroneous.

TIGTA estimates the use of correctable error authority, along with expanded use of the Department of Health and Human Services National Directory of New Hires, could have prevented the

issuance of approximately \$2 billion in questionable Earned Income Tax Credit claims in Tax Year 2012.

Chairman Crenshaw, Ranking Member Serrano, members of the subcommittee, thank you for the opportunity to share my views.

Mr. CRENSHAW. Well, thank you very much.

[The information follows:]

**HEARING BEFORE THE
COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT
U.S. HOUSE OF REPRESENTATIVES**

“Oversight Hearing - Internal Revenue Service”



**Testimony of
The Honorable J. Russell George
Treasury Inspector General for Tax Administration**

February 25, 2015

Washington, D.C.

TESTIMONY
OF
THE HONORABLE J. RUSSELL GEORGE
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
before the
COMMITTEE ON APPROPRIATIONS, SUBCOMMITTEE ON
FINANCIAL SERVICES AND GENERAL GOVERNMENT
U.S. HOUSE OF REPRESENTATIVES

“Oversight Hearing - Internal Revenue Service”

February 25, 2015

Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to testify on opportunities for the Internal Revenue Service (IRS) to perform its mission efficiently and effectively.

The Treasury Inspector General for Tax Administration, also known as “TIGTA,” is statutorily mandated to provide independent audit and investigative services necessary to improve the economy, efficiency, and effectiveness of the IRS, including the IRS Chief Counsel and the IRS Oversight Board. TIGTA’s oversight activities are designed to identify high-risk systemic inefficiencies in IRS operations and to investigate exploited weaknesses in tax administration. TIGTA’s role is critical in that we provide the American taxpayer with assurance that the approximately 91,000¹ IRS employees, who collected over \$3.1 trillion in tax revenue, processed over 242 million tax returns and other forms, and issued \$374 billion in tax refunds² during Fiscal Year (FY)³ 2014, perform their duties in an effective and efficient manner while minimizing the risks of waste, fraud, or abuse.

Achieving program efficiencies and cost savings is imperative, as the IRS must continue to carry out its mission with a significantly reduced budget. In FY 2014, the IRS budget was approximately \$11.3 billion in appropriated resources, \$850 million less than its FY 2010 level. During the same period, the IRS lost over 11,000 full-time permanent employees. The IRS’s approved budget for FY 2015 was further reduced to \$10.9 billion, resulting in a cut of approximately \$346 million in appropriated resources from FY 2014.

¹ Total IRS staffing as of January 24, 2015. Included in the total are approximately 19,000 seasonal and part-time employees.

² IRS, *Management’s Discussion & Analysis, Fiscal Year 2014*, page 2.

³ The Federal Government’s fiscal year begins on October 1 and ends on September 30.

TIGTA reported that implementation of the mandated sequestration,⁴ coupled with a trend of lower budgets, reduced staffing, and the loss of supplementary funding for the implementation of the Patient Protection and Affordable Care Act (Affordable Care Act),⁵ affected the IRS's ability to deliver its priority program areas, including customer service and enforcement activities.⁶ The IRS's toll-free Level of Service⁷ decreased from 68 percent in FY 2012 to 61 percent in FY 2013. Key examination and collection statistics also declined. Examinations of individual tax returns declined approximately five percent from FY 2012 to FY 2013; and collection activities initiated by the IRS, such as liens, levies, and property seizures, declined approximately 33 percent during the same period. Our analysis of select customer service and enforcement statistics indicates that the downward trend in these areas may continue.

For example, budget cuts have resulted in significant declines in the performance of the IRS collection program.⁸ From FY 2010 to FY 2014, the budgets for the Automated Collection System (ACS)⁹ operations and Field Collection were reduced by over \$269 million. ACS staffing has been reduced by 24 percent since FY 2011, and the number of revenue officers has decreased 24 percent since FY 2011. As a result, in FY 2014 revenue officers closed 34 percent fewer cases than in FY 2011 and collected \$222 million less than in FY 2011. In the ACS, contact representatives answered 25 percent fewer calls in FY 2014 than in FY 2011 and collected \$224 million less in FY 2014 than in FY 2011.

At the same time IRS is operating with a reduced budget, it continues to shoulder increased responsibilities as it implements and administers provisions of the Affordable Care Act. This filing season represents the first time taxpayers must report on their tax return whether they and their dependents maintained minimum essential health care insurance coverage or face a tax penalty for not maintaining this coverage.

⁴ Sequestration involves automatic spending cuts of approximately \$1 trillion across the Federal Government that took effect on March 1, 2013.

⁵ Pub. L. 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, Pub. L. No. 111-152, 124 Stat. 1029.

⁶ TIGTA, Ref. No. 2014-10-025, *Implementation of Fiscal Year 2013 Sequestration Budget Reductions* (June 2014).

⁷ The primary measure of service to taxpayers. It is the relative success rate of taxpayers who call for live assistance on the IRS's toll-free telephone lines.

⁸ TIGTA, Audit No. 201330013, *Budget Cuts Resulted in Significant Declines in Key Resources and Unfavorable Trends in Collection Program Performance*, report planned for April 2015.

⁹ The Automated Collection System consists of 15 call sites with contact representatives to engage taxpayers and their representatives on resolving unpaid tax debts. Field Collection consists of over 400 offices across the country through which revenue officers contact taxpayers in person to resolve tax debts and secure unfiled returns.

The IRS must also ensure that the more than 6 million individuals who purchased insurance from a Health Care Exchange¹⁰ accurately reconcile advance payments of the Premium Tax Credit (PTC)¹¹ they may have received on their tax return. Since enactment of the Affordable Care Act, these responsibilities have required the IRS to develop new information technology, modify existing computer systems, and establish new or revised filing, reporting, and compliance processes and procedures.

Another significant IRS undertaking is the implementation of systems, policies and procedures to implement enforcement of the Foreign Account Tax Compliance Act (FATCA).¹² FATCA requires individuals owning foreign-held assets to self-report them on the new Form 8938, *Statement of Specified Foreign Financial Assets*, if funds in the aggregate exceed \$50,000. Participating foreign financial institutions (FFIs) must also register with the IRS and identify U.S. account holders, disclosing the account information to the IRS; and 30 percent withholding is imposed on payments to recalcitrant account holders and non-participating FFIs. TIGTA has begun a review of the IRS's role in implementing FATCA, which will include an analysis of how the IRS is using the information it receives to improve compliance as well as the procedures in place to account for information errors and other problems that may increase taxpayer burden.

In addition, the IRS continues to dedicate significant resources to detect and review potential identity theft tax returns as well as to assist victims. Resources have not been sufficient for the IRS to work identity theft cases dealing with refund fraud, which continues to be a concern. IRS employees who work the majority of identity theft cases are telephone assistors who also respond to taxpayers' calls to the IRS's toll-free telephone lines.¹³ This has contributed to the IRS's inability to timely resolve victims' cases as well as the continued decline in its ability to timely respond to taxpayers' written correspondence. The allocation of limited resources requires difficult decisions, with a focus on balancing taxpayer assistance on the toll-free telephone lines during the filing season with other various priority programs, such as identity theft and aged work.

For example, the IRS previously reallocated ACS staff, who attempt to collect taxes through telephone contact with taxpayers, to work the growing inventory of

¹⁰ Exchanges are intended to allow eligible individuals to obtain health insurance, and all Exchanges, whether State-based or established and operated by the Federal government, are required to perform certain functions.

¹¹ A refundable tax credit to assist individuals and families in purchasing health insurance coverage through an Affordable Insurance Exchange.

¹² Pub. L. No. 111-147, 124 Stat 71 (2010).

¹³ The IRS refers to the suite of 29 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

identity theft cases. The combination of fewer resources and the need to continue answering telephone calls has contributed to trends that have been unfavorable to several ACS business results over the past four years. Specifically, we determined that inventory is growing because new inventory is outpacing case closures, cases in inventory are aging because inventory is taking longer to close, revenue declined while more cases were closed as uncollectible, and fewer enforcement actions (liens and levies) were taken.¹⁴

During the past several years, the IRS has continued to take steps to more effectively detect and prevent the issuance of fraudulent refunds resulting from identity theft tax return filings. The IRS reported that in Filing Season 2013, its efforts prevented between \$22 billion and \$24 billion in identity theft tax refunds from being issued.¹⁵ This is a result of the IRS's continued enhancement of filters used to detect tax returns that have a high likelihood that they involve identity theft at the time the returns are processed. For example, the IRS used 11 filters in Processing Year 2012 to identify tax returns with a high likelihood of involving identity theft, compared to 114 filters used in Processing Year 2014. The use of these filters assists the IRS in more effectively allocating its resources to address identity-theft tax refund fraud.

The IRS has also taken steps to more effectively prevent the filing of identity theft tax returns by locking the tax accounts of deceased individuals to prevent others from filing a tax return using their name and Social Security Number. The IRS has locked approximately 26.3 million taxpayer accounts between January 2011 and December 31, 2014. In addition, the IRS issues an Identity Protection Personal Identification Number (IP PIN) to any taxpayer who is a confirmed victim of identity theft or who has reported to the IRS that he or she could be at risk of identity theft. Once the IRS confirms the identity of a victim or "at-risk" taxpayer, the IRS will issue the taxpayer an IP PIN for use by the taxpayer when filing his or her tax return. The presence of a valid IP PIN on the tax return tells the IRS that the rightful taxpayer filed the tax return, thus reducing the need for the IRS to screen the tax return for potential identity theft. The IRS has issued more than 1.5 million IP PINs for Processing Year 2015.

Despite these improvements, the IRS recognizes that new identity theft patterns are constantly evolving and, as such, it needs to adapt its detection and prevention processes. The IRS's own analysis estimates that identity thieves were successful in receiving over \$5 billion in fraudulent tax refunds in Filing Season 2013. This will

¹⁴ TIGTA, Ref. No. 2014-30-080, *Declining Resources Have Contributed to Unfavorable Trends in Several Key Automated Collection System Business Results* (Sep. 2014).

¹⁵ IRS ID Theft Taxonomy, dated September 15, 2014, page 1.

require the continued expenditure of resources that could otherwise be used to respond to taxpayer telephone calls, answer correspondence, and resolve discrepancies on tax returns. In addition, we reported that the IRS did not provide an IP PIN to 557,265 eligible taxpayers for Processing Year 2013¹⁶ and continues to make errors on the tax accounts of victims of identity theft.¹⁷ These errors further delayed refunds issued to taxpayers and required the IRS to reopen cases and expend limited resources to resolve the errors.

Another challenging area is the ongoing IRS impersonation scam. Between October 2013 and January 31, 2015, TIGTA has logged approximately 300,000 contacts from taxpayers who reported that they received telephone calls from individuals claiming to be IRS employees. The impersonators told the victims that they owed additional tax and, if not immediately paid, they would be arrested, lose their driver's licenses, or face other consequences. More than 2,700 victims have reported an aggregate loss of more than \$14.5 million dollars. While TIGTA investigates these complaints, we have worked closely with the IRS, the Federal Trade Commission and local media outlets to publish press releases, warnings, and other public awareness announcements in order to warn taxpayers of the scam. The sheer volume of contacts from concerned taxpayers is an additional strain on IRS resources.

IRS efforts to improve the identification of questionable refund claims is a significant step in protecting and maintaining the integrity of the Federal system of tax administration. However, the IRS must continue to identify and implement innovative and cost-saving strategies to accomplish its mission of providing America's taxpayers with top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness.

While the IRS faces many challenges, TIGTA has recently reported on several other areas where the IRS can achieve cost savings, more efficiently use its limited resources, and make more informed business decisions. In addition, timelier reporting of third-party data and additional authority would assist the IRS in improving tax administration.

Opportunities Exist for Additional Cost Savings

In August 2012, TIGTA reported that the IRS can achieve additional cost

¹⁶ TIGTA, Ref. No. 2014-40-086, *Identity Protection Personal Identification Numbers Are Not Provided to All Eligible Taxpayers* (Sep. 2014).

¹⁷ TIGTA, Audit No. 201340036, *Identity Theft Victim Assistance – Follow-Up*, report planned for March 2015.

savings from better managing its real property costs. TIGTA reported that the IRS completed 17 space consolidation and relocation projects from October 2010 through December 2011, which the IRS estimated would result in \$2.8 million of realized rent savings in FY 2012. However, we reported that the IRS continues to incur rental costs for more workstations than required. TIGTA estimated that if the employees the IRS allows to routinely telework on a full- or part-time basis shared their workstations on days they were not in the office, 10,244 workstations could potentially be eliminated. The sharing of these workstations could allow the IRS to reduce its long-term office space needs by almost one million square feet, resulting in potential rental savings of approximately \$111 million over five years. The IRS agreed with our recommendations and indicated it would revise interim and long-range portfolio strategies for future space needs at sites to include workstation sharing as appropriate.¹⁸

In September 2014, TIGTA also reported that potential cost savings could be achieved from expanded electronic filing of business returns.¹⁹ IRS efforts have resulted in considerable growth in the electronic filing of individual tax returns, which was at an 81 percent rate in Processing Year 2012. In comparison, the electronic filing rate of business tax returns in Tax Year 2012 was 41 percent. Employment tax returns provide the most significant opportunity for growth in business electronic filing. For Tax Year 2012, more than 21.1 million (71 percent) employment tax returns were paper-filed. The Electronic Federal Tax Payment System (EFTPS) has been used in the past to facilitate the e-filing of employment tax returns for Federal agencies. TIGTA recommended that the IRS consider this option for business taxpayers. Providing businesses the ability to electronically file their tax returns concurrently with payment of their tax due on the same system could provide one-stop service which would benefit business filers.

The IRS did not agree to implement this recommendation and offered as an explanation that the Modernized e-File system has been established as the system for receiving employment tax returns electronically. This system provides taxpayers with the ability to remit tax payments when submitting their returns. Notwithstanding this explanation, the implementation of this system has not resulted in a significant increase in the e-filing rate for these tax returns. Moreover, this system does not accept quarterly employment tax deposits.

In September 2014, TIGTA reported that the IRS does not effectively manage

¹⁸ TIGTA, Ref. No. 2012-10-100, *Significant Additional Real Estate Cost Savings Can Be Achieved by Implementing a Telework Workstation Sharing Strategy* (Aug. 2012).

¹⁹ TIGTA, Ref. No. 2014-40-084, *A Service-Wide Strategy Is Needed to Increase Business Tax Return Electronic Filing* (Sep. 2014).

server software licenses and is not adhering to Federal requirements and industry best practices. Until the IRS addresses these issues, it will continue to incur increased risks in managing software licenses. TIGTA estimates that the inadequate management of server software licenses potentially costs the Government between \$81 million and \$114 million based on amounts spent for licenses and annual license maintenance that were not being used.²⁰ While the IRS agreed with our recommendation to improve the management of server software licenses, it believes it has subsequently mitigated some of these issues.

Finally, TIGTA estimates that the IRS may have issued more than \$439 million in potentially erroneous tax refunds claimed on 187,421 amended returns in FY 2012. Currently, amended tax returns can only be filed on paper and are manually processed. TIGTA's review of a statistical sample of 259 amended tax returns identified 44 tax returns (17 percent) with questionable claims. TIGTA reported that the processes the IRS uses to verify originally filed tax returns would have identified most of the 44 questionable amended returns TIGTA identified as needing additional scrutiny before the refund was paid. TIGTA forecasts using these same processes could prevent the issuance of more than \$2.1 billion in erroneous refunds associated with amended tax returns over the next five years. In addition, TIGTA reported that the IRS could have potentially saved \$17 million in FY 2012 if it allowed taxpayers to electronically file amended tax returns.²¹ The IRS agreed with TIGTA's recommendation to expand electronic filing of amended tax returns.

The IRS Could Take Actions to More Efficiently Use Its Limited Resources

TIGTA has identified other opportunities for the IRS to more efficiently use its available resources. For example, TIGTA identified potential improvements in the efficiency of the ACS.²² The ACS plays an integral role in the IRS's efforts to collect unpaid taxes and secure unfiled tax returns. ACS employees are responsible for collecting unpaid taxes and securing tax returns from delinquent taxpayers who have not complied with previous notices. The number of ACS contact representatives in FY 2013 was 39 percent less than in FY 2010 due either to attrition or reassignment, because resources are needed to answer incoming telephone calls and work identity theft cases. This resulted in fewer resources available to devote to the collection of

²⁰ TIGTA, Ref. No. 2014-20-042, *The Internal Revenue Service Should Improve Server Software Asset Management and Reduce Costs* (Sep. 2014).

²¹ TIGTA, Ref. No. 2014-40-028, *Amended Tax Return Filing and Processing Needs to Be Modernized to Reduce Erroneous Refunds, Processing Costs, and Taxpayer Burden* (Apr. 2014).

²² TIGTA, Ref. No. 2014-30-080, *Declining Resources Have Contributed to Unfavorable Trends in Several Key Automated Collection System Business Results* (Sep. 2014).

unpaid taxes. However, the IRS's overall collection inventory practices were not changed to reflect the reduced workforce and, as a result, new inventory continued to be sent to the ACS without interruption, even though inventory was infrequently worked. This has a substantial impact on the amount of Federal taxes that remain uncollected.

The IRS agreed with our recommendations to re-examine the ACS's role in the collection workflow process, including inventory delivery to the ACS as well as case retention criteria, and align ACS resources accordingly. In addition, the IRS also agreed to establish performance metrics for ACS call data to measure the impact that answering taxpayer calls has on compliance business results. Capturing these data could allow ACS management to assess the impact of prioritizing call handling versus working inventory and limiting enforcement actions in order to reduce the volume of incoming calls to the ACS.

TIGTA also found that the IRS's fieldwork collection process is not designed to ensure that cases with the highest collection potential are identified, selected, and assigned to be worked.²³ Although the IRS has begun some initiatives intended to improve the workload selection process, TIGTA believes further action is warranted.²⁴ With significant growth in delinquent accounts and a reduction in the number of employees, it is essential that the field inventory selection process identifies the cases that have the highest risk and potential for collection.

TIGTA is currently following up on our recommendations regarding inappropriate criteria the IRS used to identify organizations applying for tax-exempt status for review in the area of political campaign intervention. TIGTA has determined that the IRS has taken significant actions to (1) eliminate the selection of potential political cases based on names and policy positions, (2) expedite processing of Internal Revenue Code Section 501(c)(4) social welfare applications, and (3) eliminate unnecessary information requests.²⁵

Better Processes and Information Would Assist the IRS in Making Informed Decisions

²³ The IRS's Collection function has the primary responsibility for collecting delinquent taxes and tax returns while ensuring that taxpayer rights are protected.

²⁴ TIGTA, Ref. No. 2014-30-068, *Field Collection Could Work Cases With Better Collection Potential* (Sep. 2014).

²⁵ TIGTA, Audit Number 201410009, *Status of Actions Taken to Improve the Processing of Tax-Exempt Applications Involving Political Campaign Intervention*, report planned for April 2015.

TIGTA has also identified areas in which the IRS could make more informed business decisions when determining how to use its limited resources. For example, the IRS eliminated or reduced services at Taxpayer Assistance Centers, or TACs. This move was completed to balance taxpayer demand for services with the IRS's anticipated budget cuts, redirect taxpayers to online services, enable assistors to dedicate more time to answer tax account-related inquiries, and offer other services at the TACs, such as identity theft services and acceptance of payments. Although the IRS stated that the services eliminated or reduced were, in part, the result of the IRS's anticipated budget cuts, TIGTA reported that the IRS's plans did not show to what extent the service cuts would lower the costs.

The services the IRS reduced or eliminated at the TACs include preparation of tax returns, refund inquiries, transcript requests, and assistance with tax law questions.²⁶ These services were reduced or eliminated without evaluating the burden that the changes would have on the low-income, elderly, and limited-English-proficient taxpayers who seek face-to-face service. For example, management decided to stop providing tax transcripts at the TACs, informing customers that they should use its online application "Get Transcript." However, this decision was made with no analysis of the anticipated increase in traffic to this online application to ensure that it could meet the increased demand. In February 2014, IRS management modified its plan to stop providing transcripts at the TACs, based on concerns of the expected volume of online requests for transcripts as well as concerns raised regarding the launch of another Federal Government website. Management subsequently changed its position, alerting assistors at the TACs to encourage taxpayers to use the "Get Transcript" application but also indicated it will not turn away taxpayers who request transcripts.

Furthermore, we reported that a process has not been developed to expand Virtual Service Delivery, which integrates video and audio technology to allow taxpayers to see and hear an assistor located at remote locations. Taxpayers can use this technology to obtain many of the services available at the TACs. The IRS's stated goals for Virtual Service Delivery are to enhance the use of IRS resources, optimize staffing, and balance its workload. We recommended that the IRS establish a process to identify the best locations for virtual face-to-face services. However, the IRS did not agree to follow through on this recommendation because, in its view, it has established a process to identify the best locations for virtual face-to-face services. However, we believe that the IRS's geographic coverage methodology does not identify optimal underserved areas across the country that would benefit the most from Virtual Service

²⁶ TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 2014).

Delivery expansion.

TIGTA also found that the IRS's use of cost/benefit information in managing its enforcement resources could be significantly improved.²⁷ The allocation of enforcement resources represents an increasingly complex challenge for the IRS in light of significant reductions in its budget. Return on investment (ROI) information, including both estimated ROI for new enforcement initiatives and cost/benefit calculations based on actual program results and costs, is an important tool available to assist IRS senior executives in managing enforcement resources. Although cost/benefit information is considered in making resource allocation decisions, the IRS does not document how or to what extent it uses the information and has no policies or procedures to guide this process. TIGTA also found that the IRS continues to be unable to measure actual revenue from new enforcement initiatives funded in prior years.

We also determined that the IRS's processes do not ensure that corporations accurately claim carryforward general business credits.²⁸ During Processing Year 2013, corporate filers claimed more than \$93 billion in general business credits. These credits offset taxes owed by more than \$21 billion. TIGTA identified 3,285 e-filed Forms 1120, *U.S. Corporation Income Tax Return*, filed in Processing Year 2013 on which corporations claimed potentially erroneous carryforward credits totaling more than \$2.7 billion. We recommended the IRS develop processes to address the deficiencies identified in our report. The IRS does not plan to implement this recommendation due to lack of information technology resources and competing priorities.

In addition, TIGTA recently reported that the IRS hired some former employees with prior substantiated conduct or performance issues.²⁹ The act of rehiring former employees with known conduct and performance issues presents increased risk to the IRS and taxpayers. For example, TIGTA found that nearly 20 percent of the rehired former employees TIGTA sampled with prior substantiated or unresolved conduct or performance issues had new conduct or performance issues after being rehired. This is significant because the time spent by IRS managers addressing performance and conduct issues is time taken away from serving taxpayers and enforcing the law.

²⁷ TIGTA, Ref. No. 2013-10-104, *The Use of Return on Investment Information in Managing Tax Enforcement Resources Could Be Improved* (Sep. 2013).

²⁸ The general business credit is offered as an incentive for a business to engage in certain kinds of activities considered beneficial to the economy or the public at large and is used to reduce a corporation's regular tax liability. A carryforward is the amount of the general business credit that is unused because of the tax liability limit for claiming the credit.

²⁹ TIGTA, Ref. No. 2015-10-006, *Additional Consideration of Prior Conduct and Performance Issues Is Needed When Hiring Former Employees* (Dec. 2014).

The IRS is also dedicating significant resources towards addressing what it believes to be the most significant risks to compliance, such as the challenge presented by taxpayers' increasing use of flow-through entities, such as partnerships.³⁰ In the IRS's 2014–2017 Strategic Plan,³¹ one of its stated goals is to ensure compliance with tax responsibilities and to combat fraud, and one of its stated measures of success is an increase in voluntary compliance by three percent from 83 percent to 87 percent by 2017.

TIGTA continues to audit the efficiency and effectiveness of the IRS's efforts to reduce the Tax Gap³² and improve voluntary tax compliance. In the area of partnership compliance, for example, the IRS initiated its Partnership Strategy in July 2012 to improve the partnership audit process in light of the significant increase in partnership filings and complexities associated with auditing partnership returns. TIGTA recently completed a review of the partnership audit program and found that the IRS has no effective way to assess the productivity of its partnership audits since many complex partnerships have multiple layers of flow-through entities.³³ The IRS uses a decades' old system to track partnership audits that is unable to provide information on the total amount of taxes that are ultimately assessed to the taxable partners as a result of adjustments made to the partnership returns. Therefore, the IRS is unable to assess the full impact of its partnership compliance activities.

The IRS agrees that this is a significant problem but asserts that a new information technology system is the only means to obtain the necessary information on the productivity of its partnership compliance program. Until such time that the IRS decides to make upgrading in its systems a priority, however, TIGTA believes the IRS could make better use of the significant research capacity within the IRS to address this formidable tax compliance challenge. Although the IRS has requested over \$16 million as part of its FY 2016 budget request to increase the number of agents with specialized experience in auditing large partnerships, it has not taken the steps to improve the tracking of the results of its partnership audits so that it can make the best use of its resources devoted to this area.

More Timely Third-Party Reporting and Correctable Error Authority

³⁰ Between 2008 and 2012, the number of business partnership filings increased by 21 percent.

³¹ IRS Strategic Plan FY 2014-2017.

³² The Tax Gap is the difference between what all taxpayers owe and what they pay. The IRS estimated the net tax gap (after factoring in forced collections) to be approximately \$385 billion annually.

³³ TIGTA, Audit No. 201430027, *Additional Improvements Are Needed to Measure the Success and Productivity of the Partnership Audit Process*, report planned for March 2015.

Each year, the IRS receives information returns filed by third parties such as employers and educational institutions. These returns provide the IRS the information needed to verify taxpayers' claims for benefits such as the Earned Income Tax Credit (EITC) and the American Opportunity Tax Credit (AOTC). However, information returns are generally not filed with the IRS until after most taxpayers file their annual tax returns. As a result, the IRS cannot use the information contained on these information returns to verify tax returns until after those tax returns are processed and refunds are issued.

For example, the IRS estimates that in FY 2013, 30 percent or \$4.35 billion in improper EITC payments resulted from verification errors associated with the IRS's inability to identify taxpayers who misreport their income to erroneously claim the EITC. TIGTA's review of Tax Year 2012 tax returns identified more than \$1.7 billion in potentially erroneous EITC claims on tax returns with no third-party Forms W-2, *Wage and Tax Statement*, received by the IRS supporting the wages reported. However, the IRS does not have the Forms W-2 information at the time most of these tax returns are processed. Employers who file paper Forms W-2 are not required to file these forms until February of each year. Employers who e-file Forms W-2 have until the end of March each year to file.

TIGTA also estimates that the IRS issued more than \$3.2 billion in potentially erroneous education credits in Tax Year 2012 for students for whom the IRS did not receive a Form 1098-T, *Tuition Statement*, from a postsecondary educational institution.³⁴ Educational institutions are required to provide a Form 1098-T to students who attend their institution and file a copy of Form 1098-T with the IRS. The Form 1098-T provides the name and Employer Identification Number of the institution, the name and Taxpayer Identification Number of the student who attended, and information on whether the student attended half-time or was a graduate student. However, these forms are not available at the time the tax returns are filed. As such, the IRS is not able to use this information to identify potentially erroneous claims when tax returns are processed. As with the Form W-2, Forms 1098-T generally do not have to be filed with the IRS until the end of March each year.

Requiring third parties such as employers and educational institutions to file information returns earlier will provide the IRS the opportunity to use the information contained on these forms to verify tax returns at the time they are processed rather

³⁴ TIGTA, Audit Number 201440015, *Billions of Dollars in Potentially Erroneous Education Credits Continue to be Claimed for Ineligible Students and Institutions*, report planned for March 2015.

than after refunds are issued. This could significantly improve the IRS's ability to prevent the issuance of billions of dollars in erroneous tax benefits, including the EITC and education credits.

However, even if the third-party information returns are received more timely, the IRS still needs certain authorities to more efficiently and effectively use these data to address taxpayer noncompliance. Generally, the IRS must audit any tax return it identifies with a questionable claim before the claim can be adjusted or denied, even if the IRS has reliable data that indicate the claim is erroneous. However, the number of tax returns the IRS can audit is limited to available resources and the need to provide a balanced enforcement program among all taxpayer segments.

The IRS does have math error authority³⁵ to systemically address erroneous claims that contain mathematical or clerical errors or EITC claims with an invalid qualifying child's Social Security Number. The IRS estimates that it costs \$1.50 to resolve an EITC claim using math error authority, compared to \$278 to conduct a pre-refund audit.

However, the majority of erroneous claims the IRS identifies do not contain the types of errors for which it has math error authority. For example, in Tax Year 2011, the IRS identified approximately 6.6 million potentially erroneous EITC claims totaling approximately \$21.6 billion that it could not address using existing math error authority. In addition, the number of potentially erroneous EITC claims the IRS can audit is further reduced by its need to allocate its limited resources among the various areas of taxpayer noncompliance to provide a balanced tax enforcement program. As a result, billions of dollars in potentially erroneous EITC claims go unaddressed each year.

The Department of the Treasury has included a legislative proposal as part of the IRS's budget requests since FY 2013 to obtain correctable error authority, which would permit the IRS to disallow tax benefit claims when Government data sources do not support information on the tax return, or when taxpayers have failed to include required documentation with their tax return or exceeded the lifetime limit for claiming a deduction or credit. This authority would enable the IRS to systemically deny all tax claims for which the IRS has reliable data showing the claim is erroneous. The data available for IRS use in verifying tax returns go beyond that provided to the IRS on information returns such as the Form W-2.

³⁵ Under current law, the IRS can adjust tax returns on which the taxpayer has made a math error utilizing summary assessment procedures.

For example, the Affordable Care Act requires Health Care Exchanges to provide data to the IRS on a monthly basis for each individual enrolled in the Exchange who purchased a qualified health insurance plan, including the amount of advance Premium Tax Credits (PTC) received. The Department of Health and Human Services estimates more than six million individuals purchased insurance through an Exchange in Calendar Year 2014. The Exchange data are available at the time tax returns are processed and can be used to ensure taxpayers have purchased insurance through an Exchange as required and properly reconciled advance PTC payments on their tax return before refunds are paid. However, the IRS was not given the authority to use the Exchange data to systemically disallow a PTC claim for which the data show the claim is erroneous. As a result, the IRS must audit these tax returns.

The IRS has authority to use the Department of Health and Human Services National Directory of New Hires (NDNH) which contains wage information to verify EITC claims. However, the IRS does not have the authority to systemically disallow an EITC claim that is not supported by NDNH data. Therefore, the IRS must audit the EITC claims it identifies for which NDNH data indicate the income reported is potentially erroneous. TIGTA estimates the use of correctable error authority along with expanded use of the NDNH could have potentially prevented the issuance of the more than \$1.7 billion in questionable EITC claims in Tax Year 2012 for which the IRS had no Form W-2 from an employer. TIGTA forecasted that these processes could prevent the issuance of more than \$8.5 billion in potentially erroneous EITC claims over the next five years.

A similar issue also exists with education credits. To qualify for an education credit, students must attend a postsecondary educational institution that is certified by the Department of Education to receive Federal student aid funding. The Department of Education Postsecondary Education Participants System (PEPS) database includes all educational institutions certified to receive Federal student aid funding. TIGTA's comparison of Tax Year 2012 tax returns with the Department of Education PEPS database identified more than 1.6 million taxpayers who received education credits totaling approximately \$2.5 billion for students who attended institutions that are not certified to receive Federal student aid funding. As with the EITC, the IRS must audit these tax returns before the erroneous claim can be denied.³⁶

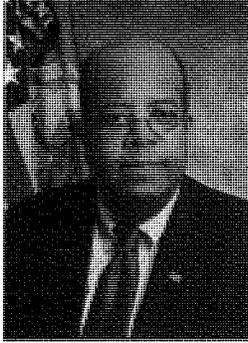
Despite the IRS's numerous efforts, it is unlikely they will achieve any significant reduction in erroneous payments without more timely access to third-party information

³⁶ TIGTA, Audit Number 201440015, *Billions of Dollars in Potentially Erroneous Education Credits Continue to be Claimed for Ineligible Students and Institutions*, report planned for March 2015.

and the ability to systemically deny erroneous claims at the time a tax return is processed. Given the scope of the improper payments that the IRS reports each year, in addition to the improper payments that remain unreported, changes in existing compliance methods could have a significant financial impact by enabling the IRS to more efficiently and effectively address this problem.

We at TIGTA are committed to delivering our mission of ensuring an effective and efficient tax administration system and preventing, detecting, and deterring waste, fraud, and abuse. As such, we plan to provide continuing audit coverage of the IRS's efforts to operate efficiently and effectively and investigate any instances of IRS employee misconduct or fraud in IRS operations.

Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to share my views.



J. Russell George

Treasury Inspector General for Tax Administration

Following his nomination by President George W. Bush, the United States Senate confirmed J. Russell George in November 2004, as the Treasury Inspector General for Tax Administration. Prior to assuming this role, Mr. George served as the Inspector General of the Corporation for National and Community Service, having been nominated to that position by President Bush and confirmed by the Senate

in 2002.

A native of New York City, where he attended public schools, including Brooklyn Technical High School, Mr. George received his Bachelor of Arts degree from Howard University in Washington, DC, and his Doctorate of Jurisprudence from Harvard University's School of Law in Cambridge, MA. After receiving his law degree, he returned to New York and served as a prosecutor in the Queens County District Attorney's Office.

Following his work as a prosecutor, Mr. George joined the Counsel's Office in the White House Office of Management and Budget where he was Assistant General Counsel. In that capacity, he provided legal guidance on issues concerning presidential and executive branch authority. He was next invited to join the White House Staff as the Associate Director for Policy in the Office of National Service. It was there that he implemented the legislation establishing the Commission for National and Community Service, the precursor to the Corporation for National and Community Service. He then returned to New York and practiced law at Kramer, Levin, Naftalis, Nessen, Kamin & Frankel.

In 1995, Mr. George returned to Washington and joined the staff of the Committee on Government Reform and Oversight and served as the Staff Director and Chief Counsel of the Government Management, Information and Technology subcommittee (later renamed the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations), chaired by Representative Stephen Horn. There he directed a staff that conducted over 200 hearings on legislative and oversight issues pertaining to Federal Government management practices, including procurement policies, the disposition of government-controlled information, the performance of chief financial officers and inspectors general, and the Government's use of technology. He continued in that position until his appointment by President Bush in 2002.

In addition to his duties as the Inspector General for Tax Administration, Mr. George serves as a member of the Recovery Accountability and Transparency Board, a non-partisan, non-political agency created by the American Recovery and Reinvestment Act of 2009 to provide unprecedented transparency and to detect and prevent fraud, waste, and mismanagement of Recovery funds. There, he serves as chairman of the Recovery.gov committee, which oversees the dissemination of accurate and timely data about Recovery funds.

Mr. George also serves as a member of the Integrity Committee of the Council of Inspectors General for Integrity and Efficiency (CIGIE). CIGIE is an independent entity within the executive branch statutorily established by the Inspector General Act, as amended, to address integrity, economy, and effectiveness issues that transcend individual Government agencies; and increase the professionalism and effectiveness of personnel by developing policies, standards, and approaches to aid in the establishment of a well-trained and highly skilled workforce in the offices of the Inspectors General. The CIGIE Integrity Committee serves as an independent review and investigative mechanism for allegations of wrongdoing brought against Inspectors General.

Mr. CRENSHAW. Now we will turn to Ms. Olson.

Ms. OLSON. Chairman Crenshaw, Ranking Member Serrano, and distinguished members of this subcommittee, thank you for inviting me today to share my concerns about the problems taxpayers are facing in their dealings with the IRS.

In my 2014 annual report to Congress, I designated inadequate taxpayer service as the number one most serious problem facing taxpayers. This year, taxpayers are receiving the worst levels of taxpayer service since at least 2001, when the IRS implemented its current performance measures.

Taxpayers call and write the IRS not only to get the answers to tax law questions, refund status or transcripts, but also to request penalty abatements, respond to math error notices, and make payment arrangements.

Yet, from January 1 through February 14 of this year, the IRS answered only 43 percent of the calls it received from taxpayers seeking to speak with a customer service representative, and those taxpayers who managed to get through sat on hold for an average of about 28 minutes.

By comparison, during the same period last year, 77 percent of taxpayers got through and waited on hold an average of 10 minutes. The IRS is now only answering the most basic of tax law questions through April 15 and none after that date, and it is no longer preparing tax returns for the most vulnerable taxpayer populations, namely, the elderly, the disabled, and the low-income.

This performance decline is huge and results from a combination of more work and reduced resources. On the workload side, the IRS is receiving 11 percent more returns from individuals, 18 percent more returns from business entities, and 70 percent more telephone calls (through fiscal year 2013) than a decade ago, not to mention the Affordable Care Act implementation.

On the funding side, the IRS's budget has been reduced by about 17 percent in inflation-adjusted terms since fiscal year 2010. As a consequence, the IRS has reduced its workforce by nearly 12,000 employees and it projects it will have to reduce its workforce by several thousand additional employees during fiscal year 2015.

Like any agency, I believe the IRS can operate more effectively and efficiently in certain areas. However, I do not see any substitute for sufficient personnel if high-quality taxpayer service is to be provided.

The only way the IRS can assist the tens of millions of taxpayers seeking to speak with an IRS employee is to have enough employees to answer the phones. The only way the IRS can timely process millions of taxpayer letters is to have enough employees to read the letters and act on them. And the only way the IRS can meet the needs of the millions of taxpayers who visit its walk-in sites is to have enough employees to staff them.

Now, while I believe the IRS requires more funding on the taxpayer service side, I also believe it is incumbent on the IRS to spend the resources it has as effectively and efficiently as possible. Reductions in services always should be made with the goal of minimizing the impact on taxpayers and on performance. I find it difficult to ascertain exactly how the IRS made its resource alloca-

tion decisions with respect to taxpayer service or what data it relied upon.

I have proposed a ranking methodology for the major taxpayer service activities for individuals. This new methodology will take taxpayer needs and preferences into account while balancing them against the IRS's need to conserve limited resources.

Frequently, taxpayer needs are best met by personal services that are more costly to the IRS than automated services, such as Internet-based services. While it may be tempting to migrate taxpayer service toward low-cost self-assistance options in the current budget environment, such efforts may ultimately be wasted and costly if the IRS does not properly address taxpayers' actual service needs.

In the absence of a ranking methodology that takes into consideration the taxpayers' needs, the IRS will continue to make difficult resource allocation decisions based on limited data and gut instinct rather than through comprehensive analytic rigor.

In my testimony and in my 700-page annual report to Congress, I have provided numerous other examples of programs in which I believe the IRS can utilize its resources more effectively and efficiently, including the math error program, identity theft, the automated substitute for return program, audit selection, and collection case selection.

The best way for Congress to hold the IRS accountable for how it allocates resources and makes decisions is through active, consistent oversight of the agency not just on the issue du jour, but on the routine work the IRS does. This hearing is an example of just such effective oversight.

It is critical that the IRS take steps to rebuild Congressional trust. It is also critical, in my opinion, that Congress provide the oversight and funding that the IRS needs to do its important work of helping taxpayers meet their tax obligations and collecting the revenue on which the rest of the Government depends. In my written statement, I have tried to offer some recommendations to help in this regard.

[The information follows:]

WRITTEN STATEMENT OF

NINA E. OLSON

NATIONAL TAXPAYER ADVOCATE

HEARING ON

INTERNAL REVENUE SERVICE OVERSIGHT

BEFORE THE

SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT

COMMITTEE ON APPROPRIATIONS

U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 25, 2015

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Chairman Crenshaw, Ranking Member Serrano, and distinguished Members of this Subcommittee:

Thank you for inviting me today to present my perspective on the problems taxpayers are facing in their dealings with the Internal Revenue Service.¹

In my 2014 Annual Report to Congress, I designated inadequate taxpayer service as the #1 most serious problem for our nation's taxpayers. This year, taxpayers are receiving the worst levels of taxpayer service since at least 2001, when the IRS implemented its current performance measures.

From January 1 through February 14, the IRS answered only 43 percent of the calls it received from taxpayers seeking to speak with a customer service representative, and those who managed to get through waited on hold for an average of about 28 minutes.² By comparison, 77 percent of taxpayers got through and waited on hold an average of about 10 minutes during the same period last year.³

Simply put, the IRS has to do a better job of meeting taxpayer needs. To assess how to do so, I think it is helpful to start with first principles.

Research conducted by the Taxpayer Advocate Service (TAS) and others has found that, at least for the sole proprietor population, a taxpayer's trust in the government, trust in the IRS, and trust in the fairness of the tax laws correlate with that taxpayer's tax-law compliance. TAS Research has also found for this population that taxpayer service is one of the two most influential factors affecting compliance.⁴

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 IRS Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Feb. 14, 2015).

³ *Id.*

⁴ Social norms are shared beliefs – within a particular group, community, or culture – about the manner in which people should behave. A social norm can be internalized and thus become a personal, or ethical or moral, norm. External norms of behavior can alter or influence a person's internal norms (e.g., where a taxpayer whose personal ethic of integrity conflicts with the taxpayer's perception that other taxpayers cheat on their taxes). Recent TAS studies analyzed the impact that social norms and other potential factors have on the compliance behavior of sole proprietor taxpayers. See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, at 33 (*Small Business Compliance: Further Analysis of Influential Factors*). See also National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 1 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

The IRS has limited control over whether taxpayers have trust in government generally, and it cannot control the fairness of the tax laws that Congress writes. But it does have a significant say over whether taxpayers view its own actions as fair and impartial – and compassionate.

Today, the IRS, as the tax administrator for the Federal government, must work to strengthen trust with two constituencies – the taxpaying public and Congress. In my view, the paths to strengthening trust with these two constituencies are similar but not identical.

With respect to the taxpaying public, trust will not be rebuilt until the IRS begins to provide the taxpayer service that taxpayers expect, need, and deserve to comply with the tax laws. Ultimately, I do not believe that can happen until the IRS receives additional funding to hire more customer service employees to answer taxpayers' telephone calls, process taxpayers' correspondence in a timely manner, and assist taxpayers who seek assistance at its walk-in sites.

Another trust-building step the IRS can take is to incorporate the principles of the Taxpayer Bill of Rights into every nook and cranny of its actions. To assist in this regard, I have recommended that Congress codify the Taxpayer Bill of Rights that the IRS adopted last year⁵ and enact specific protections to give the Taxpayer Bill of Rights teeth.

With respect to trust between Congress and the IRS, we cannot ignore that this trust has been seriously eroded in recent years. While opinions vary widely over the extent of IRS management mistakes, there is little doubt that the IRS will need to show Congress that it is a responsible steward of its resources before it receives additional funding. Specifically, the IRS must be able to demonstrate that it is making responsible decisions in allocating its existing resources; that it is basing these decisions on research data that is comprehensive, not just on what is convenient for the IRS; and that it has a strategic and creative vision for the future – one that considers the needs of taxpayers even as it tries to go about doing its work efficiently. In this context, I use "creative" to mean a willingness to review long-held approaches that are based on an outdated understanding of taxpayer behavior and to examine all IRS activities to identify areas that create re-work for itself and unnecessary burden for taxpayers.

In short, I believe the IRS must conduct a comprehensive audit of itself and all of its activities in light of what we know about U.S. taxpayers in the 21st century and the economy and circumstances within which they live and work. And importantly, that examination must be conducted from the perspective of both the IRS's needs and taxpayers' needs. By statute, the National Taxpayer Advocate serves as the voice of the taxpayer within the IRS. I therefore think it is important that the IRS take my office's

⁵ See IRS News Release, IR-2014-72, *IRS Adopts "Taxpayer Bill of Rights;" 10 Provisions to be Highlighted on IRS.gov, in Publication 1* (June 2014).

recommendations seriously, as they originate in what we observe in our cases and in what taxpayers communicate to us.

In my testimony today, I will elaborate on the following key points:

1. The IRS is currently failing to meet taxpayer needs, which erodes taxpayer trust in the system and undermines voluntary compliance.
2. The IRS is making resource-allocation decisions without hard data to show that its decisions are the best ones to drive voluntary compliance and collect revenue in an effective and efficient manner.
3. Understanding the taxpayer base is key to providing effective taxpayer service and to maintaining and enhancing voluntary compliance.
4. IRS compliance initiatives are often based on outdated or unproven assumptions and can generate significant volumes of rework for the IRS and tremendous burden for taxpayers.
5. The IRS is undertaking a review of its approach to tax compliance and service delivery, but greater transparency and Congressional oversight would improve taxpayers' confidence and trust in the tax system.

I. The IRS Is Currently Failing to Meet Taxpayer Needs, Which Erodes Taxpayer Trust in the System and Undermines Voluntary Compliance.

The tax code as it stands today is overwhelming in its complexity and thus poses a significant compliance barrier for taxpayers. Large numbers of taxpayers contact the IRS for assistance. In addition to publishing forms and instructions, the IRS now typically receives more than 100 million telephone calls,⁶ 10 million letters,⁷ and five million visits from taxpayers each year.⁸

The IRS reached its high-water mark in providing taxpayer service in fiscal year (FY) 2004, when it answered 87 percent of the calls it received from taxpayers seeking to speak with an assistor and hold times averaged 2.5 minutes;⁹ it responded to a wide range of tax-law questions from taxpayers both on its toll-free lines and in its roughly

⁶ IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2008 through FY 2014).

⁷ IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2008 through FY 2014)*.

⁸ IRS Wage & Investment Division, Business Performance Review 7 (4th Quarter – FY 2014, Nov. 6, 2014).

⁹ IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2004).

400 walk-in sites; it prepared nearly 500,000 tax returns for taxpayers who requested help, particularly low income, elderly, and disabled taxpayers;¹⁰ and it maintained a robust outreach and education program, estimating that its outreach efforts touched 72 million taxpayers.¹¹

By comparison, the IRS's service expectations for FY 2015 are as follows:

- The IRS is unlikely to answer even 50 percent of the telephone calls it receives.¹²
- For taxpayers who manage to get through, wait times are expected to be at least 30 minutes on average¹³ and will run considerably longer during peak periods.
- The IRS will answer far fewer tax-law questions than it used to. During the filing season, it will not answer any questions except "basic" ones. After the filing season, it will not answer any tax-law questions at all, leaving the roughly 15 million taxpayers who file later in the year unable to get any answers to their questions by calling or visiting IRS offices.¹⁴
- The IRS has eliminated return preparation.¹⁵
- The IRS has reduced its training funds by 83 percent since FY 2010, leaving employees less equipped to do their jobs properly.¹⁶

The following chart shows the IRS's performance in handling telephone calls from January 1 – February 14, 2015, and the comparable period during 2014:

¹⁰ This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*). TAS does not have data on tax-law questions asked outside the filing season for more recent years.

¹¹ IRS Data Book, FY 2004, Table 23.

¹² Email from Commissioner Koskinen to All Employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014).

¹³ *Id.*

¹⁴ IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>. These restrictions were implemented in 2014.

¹⁵ *Id.*

¹⁶ IRS Chief Financial Officer, Corporate Budget.

IRS Telephone Performance – Jan. 1–Feb. 14, 2015¹⁷

January 1, 2015 – February 14, 2015										
Line	2014				2015				2014 to 2015 Change	
	Net Attempts (includes calls answered by automation)	Assistor Calls Answered	Customer Service Rep LOS	Avg Speed of Answer (Minutes)	Net Attempts (includes calls answered by automation)	Assistor Calls Answered	Customer Service Rep LOS	Avg Speed of Answer (Minutes)	LOS Change (Percentage Point)	ASA Change (Minutes)
Accounts Management	17,961,291	3,830,166	77%	10	16,377,979	2,613,254	43%	28	-34%	18
Individual Income Tax Line TAX-1040	2,395,224	638,076	84%	8	2,883,441	397,496	31%	24	-53%	16
Refund Hotline (1954)	8,287,856	23,999	50%	7	5,527,557	20,994	33%	25	-16%	19
W8/Individual Customer Response Line	654,575	260,237	76%	8	740,903	148,713	34%	26	-41%	17
NTA (4778)	67,064	27,628	57%	10	105,480	26,558	37%	24	-20%	14
Practitioner Priority Line (PPS)	235,346	145,494	73%	21	222,769	86,690	46%	58	-27%	36

The official measure of IRS telephone performance is based on calls made to the “Accounts Management” telephone lines. So far this year, the IRS has answered only 43 percent of calls from taxpayers seeking to speak with a telephone assistor, and wait times for those who got through averaged 28 minutes.¹⁸ That is an extraordinary decline from last year, when the IRS answered about 77 percent of its calls, with an average wait time of 10 minutes for the comparable time period. The other rows on the chart show important telephone lines that are subsets of the Accounts Management total.

As the filing season has kicked into higher gear, the IRS’s telephone performance has dropped below the year-to-date average. For the week ending February 7, the IRS answered 34 percent of its calls,¹⁹ and for the week ending February 14, it answered 36 percent.²⁰

¹⁷ IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Feb. 14, 2015).

¹⁸ The percentage of calls answered from taxpayers seeking to speak with a customer service representative is referred to as the Customer Service Representative Level of Service, which is abbreviated as “Customer Service Rep LOS” on the above chart. The wait time for callers who get through to a customer service representative is referred to as the Average Speed of Answer, which is abbreviated as “Avg Speed of Answer (Minutes)” on the above chart. In both cases, we have rounded to the nearest whole numbers, but the LOS change and ASA change columns were computed using decimals and therefore do not all total exactly.

¹⁹ IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Feb. 7, 2015).

²⁰ IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Feb. 14, 2015).

The IRS's ability to timely process taxpayer correspondence has also been declining. The following chart shows open inventory levels and the percentage of the inventory that was not handled within established timeframes for two key programs run by the Accounts Management function:

IRS Correspondence Performance – Jan. 1–Feb. 14, 2015²¹

Accounts Management Correspondence Inventories (Weeks ending 02/15/2014 and 02/14/2015)								
Key AM Programs	2014			2015			2014 to 2015 Change	
	Total	Overage	Percentage Overage	Total	Overage	Percentage Overage	Overage Change	Overage Change (Percentage Point)
Individual Taxpayer Correspondence	187,371	86,310	46%	244,370	172,384	71%	86,074	24%
Amended Return/Duplicate Filing	119,758	67,373	56%	164,038	116,123	71%	48,750	15%

In both programs, more than 70 percent of the inventories are overage (*i.e.*, have not been handled within established timeframes), which represents a substantial increase over last year's already-high levels. These lengthy backlogs in processing taxpayer correspondence often lead to adverse taxpayer impact. For a taxpayer who owes additional tax, interest charges and penalties generally will continue to accrue. For a taxpayer who has overpaid, a delay in processing correspondence may translate into a delay in receiving a refund.

Overall, the decline in the IRS's taxpayer service levels results from a combination of more work and reduced resources. On the workload side, the IRS is receiving 11 percent more returns from individuals,²² 18 percent more returns from business entities,²³ and 70 percent more telephone calls (through FY 2013) than a decade ago.²⁴ Implementation of the Patient Protection and Affordable Care Act²⁵ during the current filing season will add considerable new work.

²¹ IRS, Customer Account Services Accounts Management Paper Inventory Reports, *Inventory Age Report – All Programs* (week ending Feb. 14, 2015).

²² See IRS Data Books, Table 2 (showing return totals for FY 2005 through FY 2013). Data for FY 2014 are projections made by the IRS Office of Research, Analysis, and Statistics; see IRS Publication 6292, *Fiscal Year Return Projections for the United States 2014-2021*, at 4 (Fall 2014).

²³ *Id.*

²⁴ The majority of the additional calls were handled by automation. The increase in calls seeking to speak with a customer service representative was 23 percent. See IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of fiscal years 2005 and 2013) (indicating that the number of calls seeking to reach a representative on the Account Management telephone lines increased from about 40.4 million to about 49.8 million). The percentage increase in calls seeking to reach an assistor likely would have been considerably higher absent IRS policies that have increasingly restricted personal service options.

²⁵ Pub. L. No. 111-148, 124 Stat. 119 (2010).

On the funding side, the IRS's budget has been reduced by about 17 percent in inflation-adjusted terms since FY 2010.²⁶ As a consequence, the IRS has already cut its workforce by nearly 12,000 employees,²⁷ and projects it will have to cut several thousand additional positions during FY 2015.²⁸

I believe the IRS, like any agency, can operate more effectively and efficiently in certain areas. However, I do not see any substitute for sufficient personnel if the IRS is to provide high-quality taxpayer service. The only way the IRS can assist the tens of millions of taxpayers seeking to speak with an IRS employee is to have enough employees to answer their calls. The only way the IRS can timely process millions of taxpayer letters is to have enough employees to read the letters and act on them. And the only way the IRS can meet the needs of the millions of taxpayers who visit its walk-in sites is to have enough employees to staff them.

The requirement to file a tax return and pay taxes is generally the most significant burden a government imposes on its citizens. The government has a duty to make compliance as simple and painless as possible. I am deeply concerned that the government is largely turning its back on the significant number of taxpayers who require personal assistance to comply with their tax obligations.

I believe that Congress and the IRS have a shared responsibility to ensure that the taxpayers who pay our nation's bills receive the assistance they need when they seek to meet their tax obligations. As I wrote in my recent report, I do not think it is acceptable for the government to tell millions of taxpayers who seek help each year, in essence, "We're sorry. You're on your own."

Recommendations

I recommend that Congress:

- Over the short term, carefully monitor taxpayer service trends and ensure that the IRS receives the oversight and funding it requires to meet the needs of U.S. taxpayers.

²⁶ In FY 2010, the agency's appropriated budget stood at \$12.1 billion. In FY 2015, its budget was set at \$10.9 billion, a reduction of about 9.9 percent. Inflation over the same period is estimated at about 9.4 percent. Adjusting for the interactive effects of these cuts and the impact of the federal pay freeze, we estimate the inflation-adjusted reduction in funding was about 17 percent.

²⁷ IRS Chief Financial Officer, Corporate Budget. This reduction represents actual full-time equivalent employees realized through appropriated dollars.

²⁸ Email from Commissioner Koskinen to All Employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014). The IRS anticipates it can make these reductions through attrition.

- Over the longer term, enact comprehensive tax reform to reduce the complexity of the Internal Revenue Code and reduce compliance burdens on taxpayers and the IRS alike.

II. **The IRS Is Making Resource-Allocation Decisions Without Hard Data to Show That Its Decisions Are the Best Ones to Drive Voluntary Compliance and Collect Revenue in an Effective and Efficient Manner.**

While I believe the IRS requires more funding, I also believe it is incumbent on the IRS to spend the resources it has as effectively and efficiently as possible. Doing so is always important, but in light of Congress's concerns about IRS management decisions, it is particularly important now for the IRS to demonstrate that it is a good steward of the funding it is given. Funding reductions, even significant ones, do not provide a blanket justification for service reductions. Reductions in service always should be made with the goal of minimizing the impact on taxpayers and performance. The IRS has had to make difficult choices and it is trying hard, but I am not convinced it is making the right choices for taxpayers or for itself. I question the decisions to substantially stop providing answers to tax-law questions by phone or in its walk-in offices. One would think that answering tax-law questions would be seen as a core function the federal tax agency should perform, and I do not believe the IRS undertook a comprehensive analysis, comparing the cost savings associated with curtailing answers to tax-law questions, against other ways of achieving equivalent savings.

Another concern is the IRS's decision to cut back the availability of the forms and publications taxpayers require to prepare their returns. Not only has the IRS reduced the number and types of forms, instructions, and publications that it will print and distribute this year, but it is delaying the delivery of those documents to its Taxpayer Assistance Centers (TACs) and its Tax Form Outlet Partners (TFOPs), including libraries and post offices. Forms will not be available at these sites until February 28, almost halfway through the filing season.²⁹ Moreover, the IRS ordered fewer forms this year than in previous years and decided not to stock Form 1040EZ in its own walk-in sites. Once a TAC or TFOP runs out of forms or publications, it cannot order more.

In an alert to all employees on February 10, 2015, the IRS acknowledged that these changes have "created questions and concerns from taxpayers."³⁰ The IRS has advised its employees that they should not give out the 1-800 number for ordering tax forms and publications unless the taxpayer affirmatively states that he or she does not have a computer or Internet access or otherwise presses the IRS employee about ordering by telephone.³¹

²⁹ IRS, *Talking Points About IRS Forms Availability* (Feb. 10, 2015).

³⁰ *Id.*

³¹ IRS SERP Alert 15A0052, *Forms and Pubs in Taxpayer Assistance Centers* (revised Feb. 10, 2015).

The IRS has also decided to cease widespread distribution of Publication 17, *Your Federal Income Tax for Individuals*, which consolidates information about individual tax issues into one helpful document. The IRS based this decision on the fact that taxpayers could obtain Publication 17 content through other publications,³² thus imposing on taxpayers the burden of locating information dispersed throughout multiple publications and instructions. Each TFOP will receive one copy of Publication 17; taxpayers will have to pay to make photocopies. The IRS has advised its employees that when asked about Publication 17, they are not to tell the taxpayer about limitations on availability but instead remind the taxpayer that he or she can access the publication online or through the Government Printing Office (GPO). Taxpayers can attempt to purchase Publication 17 for \$23 from the GPO, but there is no guarantee of success. When a TAS employee recently placed an order for Publication 17 through the GPO, she received a postcard advising her that her order was cancelled and her check would be returned. As best we can tell, the IRS did not order sufficient copies to meet the demand of taxpayers willing to pay \$23 for help in complying with the tax laws.

The reductions in service on the phones go beyond taxpayers trying to call in. Tax professionals who are acting on behalf of clients in attempting to resolve problems with the IRS are reporting long wait times on the Practitioner Priority Service (PPS) hotline. In recent weeks, practitioners have reported to the National Taxpayer Advocate about hold times of up to six hours. One practitioner reported she used her office phone to dial the PPS hotline first thing in the morning so she could get in the queue, and conducted other client business on her cell phone while waiting on hold. Once she got through to the IRS and completed her business for that taxpayer, she would immediately re-dial the PPS hotline to get in the queue for her next case. Another practitioner, who had information prepared to resolve issues for six different taxpayers, reported reaching a live assistor and being told she would have to hang up and call back after the first two cases were resolved because the call had exceeded the permitted time.

Taxpayers (and practitioners) call and write the IRS not only to get answers to tax-law questions, refund status, or transcripts, but also to request penalty abatements, respond to math error notices, and make payment arrangements. The IRS faces an impossible choice in deciding which of these services is more important than the others – all are essential and necessary for a tax system based on self-assessment and reliant on voluntary compliance. An erosion of any of these services impairs taxpayers' ability to comply with the tax laws. The current state of affairs also violates essential taxpayer rights, including *the right to be informed, the right to quality to service, the right to pay no more than the correct amount of tax, the right to challenge the IRS's position and be heard, and the right to a fair and just tax system.*

³² IRS SERP Alert 15A0052, *Forms and Pubs in Taxpayer Assistance Centers* (revised Feb. 10, 2015).

The IRS's Rationale and Methodology for Making Specific Cuts in Taxpayer Service Are Unclear.

It is difficult to ascertain exactly how the IRS made its resource-allocation decisions with respect to taxpayer service or on what data it relied. For years, the IRS had been reducing taxpayer services in its TACs, including the availability of return preparation for low income, disabled, elderly, and limited English proficiency taxpayers. Having made it harder and harder for taxpayers to obtain these services, it is disingenuous for the IRS to cite the declining utilization of tax return preparation assistance as a justification for cutting these services outright. The deliberate downward trend became a self-fulfilling proposition.

Unfortunately, the measures stakeholders often apply to the IRS do not acknowledge the importance of service delivery. The typical focus is on reducing the tax gap through enforcement efforts, or improving efficiency as measured by return on investment (ROI). These are, of course, measures of fundamental importance, but they tell us nothing about the level of service the IRS is providing to taxpayers, nor do they tell us anything about the taxpayer's experience from the taxpayer's perspective. In fact, a focus on these measures to the exclusion of a meaningful set of service delivery measures ensures that the IRS will not provide a reasonable level of service to taxpayers.

Given budget constraints, the IRS's service activities inevitably compete with its enforcement programs for funding. It is relatively easy to measure the ROI of enforcement programs – just track the dollars collected attributable to an audit or a wage levy, as compared to the various costs (including employee time) associated with that audit or levy. By contrast, while research shows that taxpayer service contributes to voluntary compliance,³³ measuring the impact of service on compliance (*i.e.*, the ROI of IRS services) is at best very difficult, and should not be the basis for funding IRS service delivery. If we acknowledge that quality taxpayer service is an integral component of the IRS's mission, then funding for the Taxpayer Services account should be based on service measures and set at a level that ensures the IRS will be able to provide an adequate level of service to the nation's taxpayers.

³³ The classic economic model of compliance – that compliance depends upon the risk (or perception of risk) of being caught and the cost (punishment) if caught – does not adequately explain our high compliance rate in the tax system. Research shows that other factors, such as taxpayers' attitudes about government and their perception that they are being treated fairly by the tax system, also influence taxpayer compliance decisions. Many researchers refer to these factors collectively as "tax morale." For an introduction to the concept of tax morale, see National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-182 (*Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

The IRS Needs Better Taxpayer Service Measures that Incorporate Both the Government and Taxpayer Perspectives.

The IRS should develop and publish a comprehensive suite of service measures that can serve as the basis for funding decisions, while holding the IRS accountable for efficient service delivery.

I have elsewhere offered detailed guidelines for the creation of a portfolio of measures that would enable both the IRS and external stakeholders to evaluate the effectiveness of IRS service delivery.³⁴ These measures would also enable the IRS to identify performance gaps that could guide the creation of performance improvement goals. A principal feature of this proposed framework is the inclusion of the following types of measures for each of the IRS's service delivery channels (*i.e.*, telephone, face-to-face, online, and correspondence):

- Access – level of service, wait time (including, where applicable, time waiting for service and time waiting for a response).
- Customer satisfaction.
- Accuracy.
- Issue resolution (*i.e.*, did the IRS completely resolve the taxpayer's problem(s)?).

The IRS currently provides a level of service measure for telephone service, but it does not provide comparable access measures for other channels: Internet, correspondence, and walk-in assistance.

Stakeholders are also keenly interested in how well the IRS is delivering each of its major services (*e.g.*, return preparation, refund inquiries, tax law inquiries). I have recommended that the IRS report select service delivery measures for each of its major service activities:³⁵

- Taxpayer awareness of the availability of the various service types by channel.
- Customer satisfaction with each service type by channel.
- Issue resolution for each service type by channel.
- Access for limited English proficiency and disabled taxpayers for each service type by channel.
- Number of returns prepared by Taxpayer Assistance Centers and by the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs.

³⁴ See IRS Pub. 4701, *Annual Report to Congress: Progress on the Implementation of the Taxpayer Assistance Blueprint* (April 2009 to September 2010) 54-57.

³⁵ *Id.*

Implementation of the Service Priorities Initiative Will Provide a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions.

In response to my concerns about the erosion of taxpayer service delivery, the Wage & Investment (W&I) Division and TAS are collaborating on the development of a ranking methodology for the major taxpayer service activities offered by W&I. The new methodology will take taxpayer needs and preferences into account while balancing them against the IRS's need to conserve limited resources, thus enabling the IRS to make resource allocation decisions that will optimize the delivery of taxpayer service activities given resource constraints.³⁶ Congress will also be able to use the results of this methodology to determine whether it is adequately funding core taxpayer service activities.

The methodology measures "value" by using separate sets of criteria for taxpayers and the IRS. This is necessary because taxpayers and the IRS have different priorities. The IRS is concerned with conserving resources, especially in a tight budget environment. Taxpayers need services that will enable them to understand their tax obligations, prepare their returns, and resolve problems without undue burden. Frequently, these needs are best met by personal services that are more costly to the IRS than automated services, such as Internet-based services.

Limitations imposed by the lack of available data have delayed this initiative, and it is unclear whether the IRS will devote the resources necessary to complete development of the methodology. In the absence of this or a similar methodology, the IRS will continue to make difficult resource-allocation decisions based on limited data and gut instinct rather than through comprehensive analytic rigor.

Recommendations

I recommend that Congress:

- Encourage the IRS to continue the work it has done to date on developing a meaningful portfolio of to develop a more comprehensive suite of performance measures in the area of taxpayer service, consistent with the guidelines I have recommended.
- Encourage the IRS to complete the ranking process for the Service Priorities Project with newly available tax year 2013 data and identify all steps needed to fully populate and implement the ranking tool.

³⁶ We use the word "optimize" to mean that the ranking methodology will provide the IRS with a rigorous way to select the combination of competing taxpayer service initiatives that maximizes the "value" of service delivery given available resources.

Effective measures will help the IRS determine where it needs to improve and will assist the Appropriations Committees in determining where the IRS requires additional resources.

III. Understanding the Taxpayer Base is Key to Providing Effective Taxpayer Service and to Maintaining and Enhancing Voluntary Compliance.

In order to provide taxpayer service in an effective and efficient manner, the IRS needs to understand its taxpayer base. While in the current budget environment it may be tempting to migrate taxpayer service toward low-cost self-assistance options, such efforts may ultimately be a wasted and costly effort if the IRS does not properly address taxpayers' actual service needs.

Comprehensive Studies Demonstrate that Low Income and Other Vulnerable Taxpayer Populations Need Person-to-Person Assistance to Comply With Their Federal Tax Obligations.

To adequately address these needs and, as a result, maximize voluntary compliance, the IRS should take into consideration the following data points:

- In 2013, nearly 133 million people had incomes below 250 percent of the federal poverty level (FPL), which Congress has determined to be the income level at which taxpayers are eligible for assistance from Low Income Taxpayer Clinics (LITCs).³⁷ This is an increase of almost 16 million people since 2007.
- The percentage of persons below the 250 percent FPL threshold rose from 39.2 percent to 42.5 percent between 2007 and 2013.³⁸
- For tax year 2013, more than 63 million tax returns, or about 45 percent of the tax returns filed, reported incomes below 250 percent of the FPL.³⁹

³⁷ At least 90 percent of the taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the FPL. See IRC § 7526(b)(1)(B)(i). The U.S. Department of Health and Human Services publishes yearly poverty guidelines in the Federal Register each year, which are used to establish the 250 percent FPL thresholds. For the 2015 FPL thresholds, see 80 F.R. 3236 (Jan. 22, 2015).

³⁸ U.S. Census Bureau, *Current Population Survey, Annual Social and Economic Supplement, Age and Sex of All People, Family Members and Unrelated Individuals Iterated by Income-to-Poverty Ratio and Race, Below 250% of Poverty* (2013 and 2007 poverty data, available at <http://www.census.gov/hhes/www/poverty/data/incpovhlth/2013/index.html>).

³⁹ IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2013) (computation based on "total positive income" for income and number of exemptions for household size and includes returns filed through Oct. 2014 and based on 250 percent of HHS poverty levels for 2013).

In 2014, the Taxpayer Advocate Service, as the organization that oversees and administers the LITC program for the IRS, commissioned a survey by Russell Research to better understand the needs and circumstances of taxpayers eligible to use the clinics.⁴⁰ The program provides representation to low income individuals who need help resolving tax problems with the IRS. The "LITC-eligibles" survey had the following pertinent findings:

- A significant percentage (approximately nine percent) of LITC-eligibles has less than a high school education. Almost 30 percent of Spanish-speaking LITC-eligibles had only an elementary school education.
- Fifteen percent of LITC-eligibles reported receiving notices from the IRS. In response, 55 percent called the IRS, 29 percent replied by letter, 24 percent contacted their preparers, and nearly 20 percent did nothing. (More than one response was allowed in the survey).
- A majority of all LITC-eligibles used return preparers, as did approximately 75 percent of Spanish-speaking eligibles. However, a significant percentage of these preparers did not satisfy the very basic statutory requirements established for commercial tax return preparation under IRC § 6695(a) and (b).⁴¹ More than 15 percent of the time, for example, the preparer either did not sign the return or did not give the taxpayer a copy. This percentage rose to more than 30 percent of Spanish-speaking eligibles.

In addition, the Pew Research Center conducted several surveys to determine the percentage of adult individuals who are offline (not using the internet or email). The following shows the categories of individuals found by the surveys to have the highest *offline* rates in 2013:⁴²

- Senior citizens (aged 65+): 44 percent offline;

⁴⁰ This Random Digit Dialed (RDD) telephone survey utilized both cell phone numbers and landline numbers to reach participants. This approach was used to make sure all groups of the LITC-eligibles were represented in the survey. The survey included more than 1,100 individuals and gathered information on eligible taxpayers' awareness and use of LITC services, the types of issues for which they would consider using clinic services, and other items including demographic information. See National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 1-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*).

⁴¹ IRC § 6695(a) imposes a penalty on a tax return preparer for failure to provide a copy of the return to the taxpayer, unless the failure is due to reasonable cause and not to willful neglect. IRC § 6695(b) imposes a penalty on a tax return preparer for failure to sign a return when required by regulation to do so, unless the failure is due to reasonable cause and not to willful neglect.

⁴² Pew Research Center's Internet & American Life Project, *Who's Not Online and Why?* (Sept. 2013) (Phone survey conducted in 2013); see also Pew Research Center, *Older Adults and Technology Use: Adoption is Increasing, but Many Seniors Remain Isolated from Digital Life* (April 2014) (Phone survey conducted in 2013); Pew Research Center's Internet Project July 18 to September 30 Tracking Survey, *African Americans and Technology Use: A Demographic Portrait* (Jan. 2014).

- Adults with less than a high school education: 41 percent offline;
- Adults with high school diploma: 22 percent offline;
- Living in households earning less than \$30,000 per year: 24 percent offline;
- Living in rural areas: 20 percent offline;
- Hispanics: 24 percent offline; and
- African Americans: 20 percent offline (rising to 25 percent offline if household income is less than \$30,000 and to 37 percent for those with no high school diploma).

Finally, a 2014 online survey by Forrester Research found interesting data about the use of certain devices to conduct some transactions online. While this study was conducted online and thus excluded responses from individuals who were offline or had limited online capabilities, there were some noteworthy findings:⁴³

- On average, only 19 percent of adults search for government services and policies with a personal computer or laptop. This rate drops to 11 percent when using personal tablets and to four percent when using a mobile phone.
- With very few exceptions, the lower income brackets used all the devices to conduct online financial transactions less frequently than the national average.
- On average, 21 percent of adults use their mobile phones to check financial statements. Only 13 percent use their mobile phones to pay bills or transfer money between accounts.

I believe the LITC-eligibles survey and the Pew and Forrester findings support the need for the IRS to design a taxpayer service strategy based on the actual needs of the taxpayer population rather than focusing on short-term resource savings. For example, while online self-help tools address the needs of many taxpayers in a low-cost manner, the IRS is harming those offline taxpayers when it significantly decreases the provision of face-to-face and person-to-person telephone services. In addition, the LITC-eligibles survey findings raise questions about the appropriateness of relying on preparers as intermediaries for the low income population, especially the Spanish-speaking population within this category, and particularly with respect to the unregulated return preparer population.

⁴³ Because this survey was conducted online, the reported usage rates may be higher than for the general population. Forrester, *North American Consumer Technographics Online Benchmark Survey, Part 2* (2014).

The Lack of a Geographic Presence of Key IRS Personnel, Including Appeals Personnel, Limits the Effectiveness of IRS Taxpayer Service and Compliance Initiatives.

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) required the IRS to replace its geographic-based structure with organizational units serving groups of taxpayers with similar needs.⁴⁴ While the new taxpayer-based structure has produced some benefits, the elimination of a functional geographic presence, with IRS employees understanding the needs and circumstances of a specific geographic economy, may harm taxpayers and erode compliance. Maintaining a local presence in both service and enforcement operations is important because such presence enables the IRS to:

- Better understand local economic, social, and cultural conditions and tailor initiatives accordingly to maximize voluntary compliance;
- Identify local variations of nationwide compliance problems;
- Identify and address significant local compliance problems that are unique to a particular region and do not show up nationwide; and
- Put a local, human face on the IRS organization through the presence of employees who live in the communities and interact with taxpayers on a day-to-day basis.

When designing an outreach campaign, the IRS should give significant attention to local culture and how different messages will be received across geographic lines. Instead, IRS localized outreach and education have all but disappeared, and front-line local compliance personnel have been significantly reduced. For example:

- The Small Business/Self-Employed Division (SB/SE), which serves approximately 65 million taxpayers, has no outreach and education employees in 13 states, plus the District of Columbia.⁴⁵
- The W&I Division, which is responsible for helping approximately 126 million individuals understand and comply with their tax obligations, devotes only about

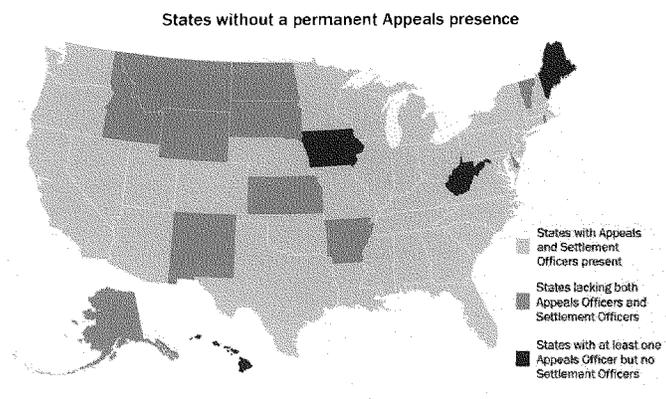
⁴⁴ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, §§ 1001(a)(1)-(3), 112 Stat. 685, 689 (1998).

⁴⁵ IRS, Individual Returns Transaction File, IRS Compliance Data Warehouse (Tax Year 2013 returns filed through Oct. 2014); IRS Human Resources Reporting Center, Report of SB/SE Job Series 0526, Stakeholder Liaison Field Employees as of November 1, 2014 (Nov. 19, 2014). The 13 states are Alaska, Delaware, Hawaii, Kentucky, Mississippi, Montana, North Dakota, Nebraska, New Hampshire, South Dakota, Vermont, West Virginia, and Wyoming.

six percent of its outreach and education budget to activities that involve face-to-face contact with taxpayers.⁴⁶

- IRS personnel in densely-populated Manhattan have decreased by 34 percent between 2001 and 2014, although filings of Forms 1040, 1120, 1120S, and 1065 increased by almost 14 percent in Manhattan between tax years (TY) 2000 and 2013.⁴⁷
- In sparsely-populated Wyoming, total tax filings increased by 22 percent between TYs 2001 and 2013, while IRS staffing dropped by more than 50 percent.⁴⁸

Almost one quarter of the states (12 out of 50) have no permanent presence by the IRS Office of Appeals, and this number of states lacking a permanent field office has increased by 33 percent, from nine to 12, since 2011.⁴⁹



⁴⁶ See National Taxpayer Advocate 2012 Annual Report to Congress 319-333 (Most Serious Problem: *The IRS Is Substantially Reducing Both the Amount and Scope of Its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of Its Remaining Outreach Activities, Thereby Risking Increased Noncompliance*). The six percent figure was as of FY 2011. Due to recent budget reductions, the percentage now may be lower.

⁴⁷ IRS Compliance Data Warehouse, Individual Returns Transaction File and Business Returns Transaction File (Tax Years 2000, 2007, and 2013).

⁴⁸ Filing data from IRS Databooks for 2001, 2008, 2013, rounded to the nearest thousand. Filing data for 2014 will not be available until March 2015.

⁴⁹ National Taxpayer Advocate 2014 Annual Report to Congress 46; IRS, Human Resources Reporting Center. The following states lack both Appeals Officers and Settlement Officers: Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, New Mexico, Rhode Island, South Dakota, Vermont, and Wyoming. The following states have at least one Appeals Officer but no Settlement Officer (to handle appeals on collection matters): Hawaii, Iowa, Maine, and West Virginia. The territory of Puerto Rico has also lacked a permanent Appeals office during this time.

Not only are states without an Appeals post of duty increasing, but the number of Appeals Officers and Settlement Officers located in existing field offices has diminished. Between the summer of 2010 and the summer of 2014, these Appeals personnel, who also comprise the group capable of traveling to states without a permanent field office (referred to as “riding circuit”), have dropped by approximately 27 percent, from 817 to 593.⁵⁰ Unsurprisingly, the overall number of Appeals cases closed via circuit riding likewise has progressively fallen in each of the last four years.⁵¹

Even where geographic coverage eventually is achieved through circuit riding, taxpayers are disadvantaged. Circuit riding Appeals cases often take an additional six months or more to resolve and have significantly lower levels of agreement than face-to-face Appeals cases conducted in field offices.⁵² Congress desired better for taxpayers, and more from the IRS, when it passed RRA 98 § 3465(b) to require that an Appeals Officer be “regularly available” within each state.⁵³

Recommendations

I recommend that Congress direct the IRS to:

- Re-staff local outreach and education positions to achieve an actual presence in every state, the District of Columbia, and Puerto Rico.
- Provide face-to-face service through the use of mobile vans and satellite offices in each state.
- Expand Appeals duty locations in a way that ensures that at least one Appeals Officer and one Settlement Officer are permanently stationed within every state, the District of Columbia, and Puerto Rico.
- Reinvigorate local compliance initiatives by increasing local staffing and research in outreach and education, Exam, Collection, and Appeals.

⁵⁰ National Taxpayer Advocate 2014 Annual Report to Congress 49; see user data from on-rolls listing, comparing personnel data from Aug. 23, 2010 with personnel data from Aug. 23, 2014.

⁵¹ *Id.* at 50; Appeals response to TAS information request (Aug. 5, 2014).

⁵² National Taxpayer Advocate 2014 Annual Report to Congress 52, Figures 3 and 4.

⁵³ Pub. L. No. 105-206, § 3465(b), 112 Stat. 685, 768 (1998).

The Elimination of Face-to-Face Services Abroad Increases Compliance Challenges for International Taxpayers and Erodes Trust in the Fairness of the U.S. Tax System.

Despite the growth of the international taxpayer base, the IRS has announced plans to eliminate all IRS tax attaché posts abroad, citing the multi-year decrease in funding.⁵⁴ As a result, over 7.5 million U.S. taxpayers living abroad,⁵⁵ over 300,000 U.S. military personnel and their families,⁵⁶ and hundreds of thousands of students and foreign taxpayers with U.S. tax obligations⁵⁷ who benefitted from the Taxpayer Assistance Centers overseas are left with the options of obtaining all their information from IRS.gov pages or calling the IRS telephone number in the United States with only about a 50 percent chance of reaching a live assistor after 30 minutes or more of wait time – and having to pay country-to-country long-distance charges for the call.⁵⁸ The elimination of overseas posts could not come at a worse time as taxpayers abroad are facing unique challenges complying with their obligations under the Foreign Account Tax Compliance Act (FATCA),⁵⁹ the Foreign Bank and Financial Accounts (FBAR) reporting requirements,⁶⁰ and the Affordable Care Act (ACA).⁶¹ The inability of international

⁵⁴ On November 30, 2014, the IRS closed its Beijing office. Memorandum from Acting Deputy Commissioner, International (LB&I), Beijing Post Closure (Oct. 16, 2014). The IRS has also announced the closure of the remaining attaché offices in U.S. Embassies in London and Paris, and the consulate in Frankfurt. Memorandum from Deputy Commissioner, International (LB&I), Post Closures of Frankfurt, London and Paris (transmitted on Feb. 18, 2015). The IRS has stated the closures will save about \$4 million a year. See David Kocieniewski, *IRS Will Shut Last Overseas Taxpayer-Assistance Centers*, Bloomberg (Jan. 14, 2015).

⁵⁵ The Department of State estimates that 7.6 million U.S. citizens live abroad and more than 70 million U.S. citizens travel abroad annually. U.S. Department of State, Bureau of Consular Affairs (May 2014), available at <http://travel.state.gov/content/dam/travel/CA%20Fact%20Sheet%202014.pdf> (last visited on Jan. 19, 2015). The number of U.S. citizens overseas increased by more than 50 percent in just five years. National Taxpayer Advocate 2013 Annual Report to Congress 205-213 (Most Serious Problem: *International Taxpayer Service: The IRS is Taking Important Steps to Improve International Taxpayer Service Initiatives, but Sustained Effort will be Required to Maintain Recent Gains*).

⁵⁶ U.S. Department of Defense, *Active Duty Military Personnel, Strength by Regional Area and by Country* (Mar. 31, 2011).

⁵⁷ National Taxpayer Advocate 2011 Annual Report to Congress 129-272. Since 2011, the National Taxpayer Advocate has recommended establishing international LTA offices at the IRS's four tax attaché offices abroad. See also National Taxpayer Advocate 2013 Annual Report to Congress 213.

⁵⁸ See IRS, *Contact My Local Office Internationally*, available at <http://www.irs.gov/uac/Contact-My-Local-Office-Internationally>. See also National Taxpayer Advocate 2013 Annual Report to Congress 205-213 (Most Serious Problem: *International Taxpayer Service: The IRS is Taking Important Steps to Improve International Taxpayer Service Initiatives, but Sustained Effort will be Required to Maintain Recent Gains*).

⁵⁹ FATCA was enacted as part of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, §§ 501(a), 511(a), 124 Stat. 71, 97, 109 (2010) (adding Internal Revenue Code (IRC) §§ 1471-1474 & 6038D). See also National Taxpayer Advocate 2013 Annual Report to Congress 238-248 (Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act Has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*).

⁶⁰ See 31 U.S.C. §§ 5314, 5321; 31 C.F.R. §§ 1010.350, 1010.306(c); FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), available at http://www.fincen.gov/forms/bsa_forms. See also National Taxpayer Advocate 2014 Annual Report to Congress 79-93 (Most Serious Problem:

taxpayers to access IRS services from abroad contributes to growing confusion and frustration about U.S. tax administration and undermines voluntary compliance.

In addition to keeping the remaining four IRS tax attaché offices open, it would be helpful to establish international Local Taxpayer Advocate (LTA) offices abroad. TAS is statutorily required to assist taxpayers in resolving their problems with the IRS, to identify areas in which taxpayers are experiencing systemic problems with the IRS, and to the extent possible, to propose changes in the administrative practices of the IRS to mitigate the problems identified.⁶² TAS is the only IRS function exclusively devoted to resolving taxpayer problems with the IRS.⁶³ The provision of basic service to taxpayers abroad would promote the taxpayer rights *to be informed, to quality service, and to a fair and just tax system*, as described in the Taxpayer Bill of Rights (TBOR) adopted by the IRS.⁶⁴ Establishing Local Taxpayer Advocate offices abroad would ensure that the IRS's international policies, processes, and procedures protect the rights granted to taxpayers by the TBOR and encourage future compliance by taxpayers dealing with the complexity and procedural burden of the international tax rules.

Recommendations

I recommend that Congress:

- Require the IRS to retain and provide funding for its four tax attaché offices abroad.
- Provide funding for and require the IRS to establish Local Taxpayer Advocates in each of those cities.

IV. IRS Compliance Initiatives Are Often Based on Outdated or Unproven Assumptions and Can Generate Significant Volumes of Rework for the IRS and Tremendous Burden for Taxpayers.

There is general agreement that the IRS is supposed to collect the correct amount of tax. This implies that the IRS has a responsibility to ensure that taxpayers do not pay

Offshore Voluntary Disclosure (OVD): The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights.

⁶¹ The Patient Protection and Affordable Care Act of 2010 (ACA), Pub. L. 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, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

⁶² IRC § 7803(c)(2)(A)(i)-(iii).

⁶³ See generally IRC §§ 7803; 7811. See also IRS Pub. 1, *Your Rights as a Taxpayer*. The law requires that there be at least one LTA for each state. See IRC § 7803(c)(2)(D)(i)(I). International taxpayers cannot access TAS or IRS personnel toll-free from abroad.

⁶⁴ IRS, *Taxpayer Bill of Rights*, at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

more taxes than they owe. Further, there is general recognition that the IRS must weigh the burden it imposes on taxpayers against its mission to collect the taxes owed. Few believe, for example, that it would be acceptable for the IRS to conduct extensive audits of every taxpayer every year. Besides being far too intrusive, such an approach would place an unreasonable financial burden on the vast majority of honest taxpayers.

The U.S. tax system is based on self-assessment, but the tax laws are complicated and become more so each year. Computing the correct amount of tax poses a daunting challenge for many taxpayers, and they frequently require assistance, which some can readily afford but millions cannot. For these taxpayers, paying for tax assistance creates a significant financial burden.

Millions of low and middle income taxpayers are "touched" annually by IRS programs that propose additional assessments, such as correspondence audits and our math error and automated underreporter (AUR) programs. Other programs hold refunds that IRS filters have identified as questionable or potentially fraudulent. These proposed additional assessments and refund holds are not always correct, but taxpayers frequently need help understanding IRS notices and other communications in order to challenge IRS positions.

In some programs, the IRS fails to use data available internally to resolve return discrepancies without contacting the taxpayer, and it thereby burdens hundreds of thousands of taxpayers a year unnecessarily. In other programs, the IRS's reliance on outdated data, processes, or assumptions, and its failure to evaluate the results of its programs from the perspective of taxpayers as well as dollars collected, leads to significant delays, increased phone calls and correspondence, and ineffective compliance policies.

In this section, I provide examples of programs in which I believe the IRS can utilize its resources more effectively and efficiently. These examples include: (1) math error processes; (2) identity theft; (3) the automated substitute for return program; (4) early intervention in collection cases; and (5) audit selection.

IRS Math Error Processes Create Significant IRS Rework and Unnecessary Taxpayer Burden.

In my 2011 Annual Report to Congress, TAS reported on a research study that reviewed IRS accuracy with respect to math error adjustments related to dependents claimed on Forms 1040. For tax year 2009, nearly 300,000 returns contained errors with dependent taxpayer identification numbers (TINs). During math error processing, the IRS disallowed over \$200 million of credits claimed on these returns, but it subsequently reversed at least part of its dependent TIN math errors on 55 percent of them. Ultimately, about 150,000 taxpayers had their refunds restored. On average, the IRS allowed nearly \$2,000 per return after the initial disallowance, with a delay of nearly

three months.⁶⁵ Furthermore, analysis of a sample of taxpayers who did not contest these assessments showed that about 40,000 taxpayers were denied refunds they were probably entitled to receive.⁶⁶

In this example, the IRS not only imposed significant burden and caused anxiety for these taxpayers, but it created significant rework for itself. TAS research identified about 55 percent of the abated math errors that could have been resolved if the IRS had used internally available data.⁶⁷ Thus, a modest investment of time to research IRS databases prior to issuing math error assessments would have eliminated the need to send out about 28 percent of the math error notices, the related phone calls and correspondence from taxpayers, and the employee time spent abating the assessments and processing later refunds.

Recommendation

I recommend that Congress:

- Ensure the IRS reviews its math error processes to identify opportunities to resolve apparent discrepancies with internally and externally available data before issuing math error notices to taxpayers.

Despite Improvement, IRS Identity Theft Processes Continue to Burden Victims and Drive Multiple Contacts and Incomplete Case Resolution.

In my 2014 Annual Report to Congress, I included the results of a case review conducted by the Taxpayer Advocate Service that analyzed a statistically significant sample of identity theft (IDT) cases closed by the IRS. The results from this review not only confirmed my suspicion that IDT cases are complex – requiring the victim to interact with multiple IRS assistors – but also revealed glaring inefficiencies in current IRS procedures. For example:

- Overall, about two-thirds (67 percent) of all IDT cases reviewed in our sample were either (1) worked in more than one function or (2) reassigned to another assistor within a function.⁶⁸

⁶⁵ The total restored to taxpayers was about \$292 million. This amount exceeds the amount of credits that were initially disallowed, because it includes both restored credits and related tax reductions (*e.g.*, taxpayers received the benefit of exemptions that were initially disallowed when the credits were disallowed). See National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 116-20 (*Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*).

⁶⁶ *Id.*

⁶⁷ *Id.* at 119.

⁶⁸ For a detailed discussion of this study, see National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, at 43 (*Identity Theft Case Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

- When a case is transferred or reassigned, it delays resolution and adds to the frustration experienced by the victim. We found that 42 percent of the cases analyzed in our sample had periods of inactivity (*i.e.*, times when no work was performed on the case for more than 30 days).
- For those cases with periods of inactivity, the average period of inactivity was 78 days.

For complex IDT cases that require the victim to deal with multiple IRS functions, I have recommended that the IRS designate a sole contact person with whom the victim can interact for the duration of the case. I believe that this approach not only will put the victim more at ease, but it will also reduce instances where IDT cases fall through the cracks, require more work, and add to cycle time.

Another finding from this IDT case review was that the IRS's global account review procedures are ineffective. Before an IDT case is closed, the IRS completes an account review to ensure that all related issues have been fully addressed. *Yet in 22 percent of the cases in our sample, the IRS had closed an IDT case without taking the appropriate steps to fully resolve the victim's account.* In these closed IDT cases, there remained unaddressed account issues – for example, a victim had not yet received a refund or the IRS failed to update the victim's address to receive an Identity Protection personal identification number. Projecting this error rate to the population of nearly 270,000 identity theft returns of this type closed in FY 2014 suggests that almost 60,000 taxpayers would face additional burden because the IRS prematurely closed their cases. Clearly, the global account review process is not working as it should, which leads to rework when the taxpayer contacts the IRS again to address the lingering IDT-related issues.

Recommendations

I recommend that Congress:

- Require the IRS to conduct comprehensive global account reviews upon receipt of an IDT case to determine whether the case involves multiple issues or years.
- Assign IDT victims with multiple issues to a sole IRS contact person who will interact with them throughout the pendency of the case and oversee its resolution, regardless of how many different IRS functions need to be involved behind the scenes.
- Conduct a comprehensive global account review prior to closing an IDT case to ensure all issues and years relating to IDT have been fully resolved.

The Automated Substitute For Return (ASFR) Program Artificially Inflates Accounts Receivables, Produces Questionable Business Results, and Needlessly Increases the Demand on IRS Collection Resources, While Creating Unnecessary Burden on Taxpayers.

The Automated Substitute for Return (ASFR) program is the key program used by the IRS to address the “non-filer” population – those taxpayers who have not filed tax returns but appear to have incurred a tax liability. The ASFR program matches third-party information returns and other data, including Forms W-2 and Forms 1099 for Miscellaneous, Brokerage, Interest, Dividend, and Cancellation of Debt income, to determine whether a taxpayer who has not filed a return has a filing requirement based on the income reported. Because the ASFR program generally treats the taxpayers as single (or married filing separately where there is evidence the taxpayer is married) with no dependents, and only allows a standard deduction (even where there is a larger mortgage interest statement on file with the IRS), these “substitutes for returns” almost always overstate the person’s tax liability. The rationale is that when the taxpayer sees the liability proposed by the IRS, the taxpayer will file a correct return.

The IRS always has more information on taxpayers than it has resources to handle, so it is very important that the IRS utilize that information in a way that drives compliance and does not generate unnecessary work for itself and taxpayers. Unfortunately, just the opposite is happening in the ASFR program.

In practice, as I discussed in my 2011 and 2012 Annual Reports to Congress, most taxpayers do not respond to proposed ASFR assessments with voluntarily filed returns, nor are these assessments paid early in the collection notice process.⁶⁹ Consequently, most become delinquent collection accounts. In FY 2014, the IRS collected (through both refund offsets and enforcement actions) approximately \$934 million in delinquent ASFR assessments. However, the IRS abated more than \$2 billion of these assessments, and it reported another \$5.3 billion as Currently Not Collectible (CNC).⁷⁰ That is, in FY 2014, the IRS abated or CNC’d almost eight times the amount of ASFR dollars it actually collected.

Each time a taxpayer calls the IRS to request an abatement or be put into CNC status, an employee has to work the case. (Sometimes more than one employee must get involved, because TAS receives its fair share of these cases.) Someone has to open the taxpayer’s correspondence and read the letter objecting to the assessment.

⁶⁹ For more detailed discussions of the National Taxpayer Advocate’s concerns and recommendations regarding the ASFR program, see 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*); National Taxpayer Advocate 2012 Annual Report to Congress 456-461 (Status Update: *The IRS’s Reliance on Automated “Enforcement Assessments” Has Declined Significantly, but Concerns Remain*).

⁷⁰ IRS, Collection Activity Report, NO-5000-242, *Type Assessment Report* (Sept. 2014).

Someone then must make the necessary adjustments to the taxpayer's account. I believe it would be a far more efficient use of resources to better identify the correct ASFR cases up front. Similarly, I believe that by placing more emphasis on personal contacts during the proposed assessment process, the IRS would significantly reduce the "downstream" costs it currently incurs to adjust these accounts.

ASFR is an example of a program I would immediately halt in its present form.⁷¹ Although the IRS has substantially scaled back the number of new ASFR assessments since I first reported on it in 2011, recent business results do not indicate that the reduced volumes of ASFR assessments have been the result of productive program changes (*i.e.*, in FY 2014, 58 percent of the closed ASFR accounts were reported as CNC and more than \$2 billion was abated).⁷² I am concerned that the reduction in ASFR assessments has been driven primarily by a lack of resources and reflects a trend that would be reversed in the future if more resources become available. That would be an unfortunate development, because even at current activity levels, further investments in the ASFR program would not appear to be a prudent use of resources. For the rest of the fiscal year, I would only use ASFR authority for those returns where there is an extremely high level of unreported income. I would simultaneously assign five or six employees (including IRS Research staff and a TAS representative) to examine the case selection rules and samples of past inventory to determine how better to screen cases for true nonfiling and design an assessment process that will result in more collected revenue and fewer abatements.

There is no doubt the IRS must devote resources to combat non-filing, and it may turn out that aspects of the ASFR program are effective. But the high rate of abatements and the large percentage of cases placed into CNC status indicate there are significant opportunities to achieve efficiencies and a higher return-on-investment if the IRS can refine its case-selection criteria to weed out the unproductive cases.

Recommendation

I recommend that Congress:

- Encourage the IRS to use this fiscal year to take a pause, scrutinize some programs, and improve them from the perspective of IRS rework, taxpayer burden, and promoting voluntary taxpayer compliance.

⁷¹ Placing a temporary pause on this program will not impair the government's ability to assess tax against these taxpayers in the future, because there is no time limit for assessing tax where a return has not been filed.

⁷² IRS, Collection Activity Report, NO-5000-242, *Type Assessment Report* (Sept. 2014).

The Taxpayer Delinquent Account Collectibility Curve Can Provide a Roadmap for How to Prioritize the Collection of Tax Debts.

A Taxpayer Delinquency Account (TDA) is a case assigned to or awaiting assignment to Collection personnel. In past Annual Reports to Congress, I have noted that many of the TDAs in the IRS Automated Collection Branch and the Collection Field function are delinquencies that have existed for several years. The following statistics highlight the age of the IRS TDA inventory:⁷³

- Overall, 53 percent of the IRS Individual Master File (IMF) TDA inventory has been in the IRS function assigned to handle the delinquency for at least 10 months (the delinquency may have been in TDA status much longer).
- More than 70 percent of the IMF TDAs in IRS inventory at the end of 2014 are Tax Year 2010 and prior liabilities (*i.e.*, they are at least four years old).
- More than 20 percent of the TDAs have less than four years remaining on the collection statute, meaning that the delinquency has existed for more than six years.

TAS Research examined the Individual Master File (IMF) Accounts Receivable Dollar Inventory (ARDI) to determine how dollars collected fluctuate as time elapses. We looked at delinquencies that originated in each of six years (2005 to 2010) and analyzed those delinquencies for the next three years. This analysis showed the following:

- Dollars collected decrease by over 50 percent from the first year to the second year and an additional 30 percent from the second year to the third year. In other words, collections are over twice as much during the first year as in the following year and over three times the collections in the third year.
- Even within that first year, collections decreased by about one-third after every three-month period elapsed.
- Not only do raw collections decrease, but the percent of the balance due collected declines as time progresses, with only about eight percent collected in the third year.
- Meanwhile, although the balance of tax due continues to decrease slightly, the amount of assessed and accrued penalties and interest continue to rise.

Budgetary constraints will make the efficient collection of delinquencies paramount. The IRS should use data on the practical delinquency collection “window” to form the basis for its Collection policies. Good information on the time available to effectively

⁷³ IRS Collection Activity Report 5000-2 (Oct. 3, 2014).

collect various delinquencies will assist the IRS in determining what liabilities should be collected first and whether it makes sense to focus on collection of smaller, more current liabilities rather than older, larger liabilities. Furthermore, this research may provide significant insights into which delinquencies are placed in the Collection TDA queue and which delinquencies are shelved. Finally, the collection curve can help demonstrate which delinquencies are able to be resolved early through collection alternatives rather than being left to fester until they become essentially unresolvable.

Recommendation

I recommend that Congress:

- Direct the IRS to revise its collection strategy to acknowledge and address the findings of the collectability curve data. Specifically, the IRS should (1) provide timely, effective interventions for emerging collection problems; (2) place more emphasis on case resolutions during the initial contacts with taxpayers; and (3) offer reasonable payment alternatives, such as installment agreements and offers in compromise, much earlier in the collection process.

Incorporating an Understanding of Taxpayer Behavior into IRS Audit Selection Will Increase the Effectiveness of Audits.

In addition to rebuilding trust through taxpayer service, the IRS can foster trust through its audit selection techniques if the IRS:

- Engages in social science and behavior research to better understand taxpayer behavior and the causes of tax noncompliance; and
- Designs compliance initiatives, including audit selection, in light of its research findings.

The IRS recognizes the importance of a more holistic approach to compliance, but it has not carried out the necessary research.⁷⁴ It continues to base compliance initiatives primarily, if not exclusively, on tax data such as returns and third-party information reports. Proceeding on the basis of social science research findings would instead allow the IRS to adopt the least intrusive enforcement measure necessary in light of known taxpayer behaviors and motivators, thereby protecting taxpayers' right to privacy.

⁷⁴ As the IRS Fiscal Year 2015 Budget Request notes: "Social science research reveals that the traditional deterrence theory, fear of detection and/or punishment, contributes a portion to actual compliance rates. Recent studies indicate that social norms, personal values, and attitudes may have a large impact on compliance decisions. Market segmentation approaches—behavioral, psychographic, and attitudinal, are widely used in commercial marketing to develop, design, and position products and services towards the right customer base. The knowledge gained from both social science and marketing research can assist the IRS with appropriate identification and alignment to the proper taxpayer." Internal Revenue Service FY 2015 Budget Request, Congressional Budget Submission 187, *available at* <http://www.treasury.gov/about/budget-performance/CJ15/10.%20-%2015.%20IRS%20CJ.pdf>.

It would also allow the IRS to take into account taxpayers' facts and circumstances, thereby protecting their right to a fair and just tax system. Demonstrating that the IRS selects returns for audit in the light of relevant research and in ways that enhance taxpayer rights would help rebuild trust in the IRS.

Other tax authorities, such as the United Kingdom (UK), have made more progress in incorporating research into audit selection processes. In 2012, for example, the UK tax authority's external research program examined why small and medium-sized businesses enter and operate in the hidden economy, identified six hidden economy "typologies," and provided insights about how to reach each group and advice on what messages to avoid for each group.⁷⁵ The UK also seeks to prevent tax noncompliance in ways that involve the tax authority only indirectly, for example by working with private industry regulators to make tax compliance a condition of retaining an operating license.⁷⁶

Recommendations

I recommend that Congress direct the IRS to:

- Incorporate applied and behavioral research into all of its compliance initiatives.
- Fund or activate compliance initiatives only pursuant to an overall strategy that establishes how the IRS will use education, outreach, partners, assistance, non-invasive compliance touches, and enforcement touches to increase compliance and how it will test the initiative, measure its success, and adjust to continuing research findings and trends.

V. The IRS Is Undertaking a Review of Its Approach to Tax Compliance and Service Delivery, But Greater Transparency and Congressional Oversight Would Improve Taxpayers' Confidence and Trust in the Tax System.

The best way for Congress to hold the IRS accountable for how it allocates resources and makes decisions is through active, consistent oversight of the agency. After Congress passed the IRS Restructuring and Reform Act of 1998, it held annual joint hearings to review, among other things, the IRS's progress in meeting its objectives and improving taxpayer service and compliance.⁷⁷ Each hearing was conducted jointly by

⁷⁵ HM Revenue & Customs, Business Customer & Strategy, Behavioural Evidence & Insight Team, *Understanding key problems for SMEs: Hidden Economy Levers, Ghosts and Moonlighters: Identifying effective levers to reduce entrants into, and encourage SMEs out of the Hidden Economy* (May 2012), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344827/report208.pdf.

⁷⁶ See Security Industry Authority (SIA), Approval Conditions, available at <http://www.sia.homeoffice.gov.uk/Pages/business-conditions.aspx>.

⁷⁷ See Pub. L. No. 105-206, § 4001, 112 Stat. 685, 783 (1998). The statute refers to a "joint review [to] be held at the call of the Chairman of the Joint Committee." The legislative history, however, makes clear

majority and minority members of the House Committees on Ways and Means, Appropriations, and Government Reform and Oversight and the Senate Committees on Finance, Appropriations, and Governmental Affairs. However, the hearings were discontinued because the legislation only required them to be held for five years.

I believe it would be helpful for Congress to resume these joint oversight hearings – not just on the issue *du jour*, but on the routine work the IRS does. Focusing on current tax administration challenges, these hearings could address issues such as how the IRS is making decisions related to taxpayer service, whether the IRS is effectively using existing resources to collect past due liabilities, whether the IRS's administration of penalties promotes voluntary compliance, and whether IRS employees have appropriate training to deal with diverse taxpayer populations. The hearings would provide a useful vehicle for multiple committees of Congress to review the IRS's progress, examine whether the IRS is meeting the needs of particular taxpayer segments and protecting taxpayer rights, gain a better understanding of potential problem areas, and help the IRS by passing legislation or providing additional funding where the IRS can demonstrate sufficient need.

The IRS is currently developing its Concept of Operations (CONOPS) for the type of tax administration it wants to transform itself into over the next few years. Thus, now is the appropriate time for Congress to conduct oversight to ensure that the IRS is creating a plan that not only works for itself, but also for taxpayers – the full diversity of our taxpayer base. Conducted in a respectful way, in full recognition of the important service the IRS provides to this nation and the serious challenges its employees face every day in fulfilling the IRS mission, the hearings can help restore trust and foster a shared sense of purpose between the IRS and Congress, and thus enhance the confidence of taxpayers as well.

Recommendation

I recommend that Congress:

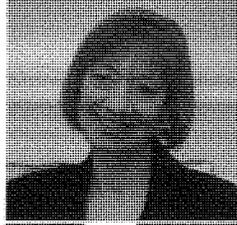
- Reinstating joint oversight hearings to review the IRS's progress in meeting its objectives and improving taxpayer service, enforcing the tax laws, and promoting voluntary compliance.

that there was to be "one annual joint hearing" before June 1 of each of the succeeding five calendar years. H.R. Rep. No. 105-599, at 328 (1998) (Conf. Rep.).

VI. Conclusion

The Federal government is currently failing badly to meet the service needs of its taxpayers. To address this problem, the IRS will need more resources to answer taxpayer telephone calls, process and respond to taxpayer correspondence, and assist taxpayers who seek assistance in its walk-in sites. The IRS can also take steps to improve its resource-allocation decisions and achieve greater efficiencies.

To be blunt, several incidents over the last few years have reduced the confidence of many Members of Congress in the leadership of the IRS. The IRS has undergone several leadership changes since that time, and I believe it is critical that Congress and the IRS now work together to find a better way forward. The IRS must take steps to rebuild congressional trust and Congress must respond by providing the IRS with the funding it needs to do its important work of helping taxpayers meet their tax obligations and collecting the revenue on which the rest of government depends. In this testimony, I have tried to offer some recommendations to help in this regard.



Nina E. Olson, the National Taxpayer Advocate (NTA), is the voice of the taxpayer within the IRS and before Congress. She leads the Taxpayer Advocate Service (TAS), an independent organization inside the IRS that helps taxpayers resolve problems and works for systemic change to mitigate problems experienced by groups of taxpayers. Since its inception in 2000, TAS has assisted more than two million taxpayers.

Throughout her career, Ms. Olson has advocated for the rights of taxpayers and for greater fairness and less complexity in the tax system. In calling for fundamental reform in 2012, she wrote, "A simpler, more transparent tax code will substantially reduce the estimated 6.1 billion hours and \$168 billion that taxpayers spend on return preparation" and "reduce the likelihood that sophisticated taxpayers can exploit arcane provisions to avoid paying their fair share of tax."

Ms. Olson was appointed to the position of National Taxpayer Advocate in January 2001. Under her leadership, the NTA's Annual Report to Congress has become an important vehicle for change. It is one of two reports the NTA is required by statute to deliver each year, and outlines the most serious problems facing taxpayers. The IRS has implemented hundreds of recommendations she has made for administrative change. Members of Congress have introduced bills to implement dozens of her recommendations for legislative change, and 15 of them have been enacted into law. In June 2014, the IRS adopted the Taxpayer Bill of Rights for which Ms. Olson had long advocated, grouping dozens of existing rights in the Internal Revenue Code into ten broad categories of rights, thereby making them clear, understandable, and accessible for taxpayers and IRS employees alike.

Ms. Olson is a member of the American College of Tax Counsel and delivered the group's prestigious Griswold Lecture in January 2010. More recently, she gave the 2013 Woodworth Lecture, sponsored by Pettit College of Law at Ohio Northern University. The non-profit Tax Foundation selected her to receive its Public Sector Distinguished Service Award in 2007. Money magazine named her one of 12 "Class Acts of 2004," and Accounting Today magazine has named her one of its Top 100 Most Influential People in the accounting profession each year since 2004.

Prior to her appointment as the NTA, Ms. Olson founded and served as Executive Director of The Community Tax Law Project, the first independent § 501(c)(3) low income taxpayer clinic in the United States. From 1975 until 1991, she owned a tax planning and preparation firm in Chapel Hill, North Carolina.

An attorney licensed in Virginia and North Carolina, Ms. Olson served as the chair of the American Bar Association (ABA) Section of Taxation's Low Income Taxpayers Committee as well as the Pro Se/Pro Bono Task Force of the ABA Section of Taxation's Court Procedure Committee. She is the 1999 recipient of both the Virginia Bar Association's Pro Bono Publico Award and the City of Richmond Bar Association's Pro Bono Award. Ms. Olson graduated from Bryn Mawr College, cum laude, with an A.B. in Fine Arts. She received her J.D., cum laude, from North Carolina Central School of Law and her Master of Laws in Taxation, with distinction, from Georgetown University Law Center. Ms. Olson has served as an adjunct professor at several law schools.

Mr. CRENSHAW. Well, thank you both for those words. Let me start by thanking you both for being here.

Inspector George, we heard from you about how the IRS could take some actions to be more efficient. They have got limited resources. We know that.

And, as Ms. Olson pointed out, I have to question—I think we all question—how they are allocating and, frankly, how they are prioritizing the resources they have.

I think there is a lot of misperception in the media. And I want to be, you know, clear. This subcommittee is not here to punish the IRS. We are just trying to hold them accountable.

We all want to be more efficient and more effective. And that is what we are trying to do, as you point out, and that includes everything from justifying the taxpayer-funded dollars to the highest level.

IMPLEMENTING RECOMMENDATIONS

So let me ask you all. You all have kind of talked about some things that you have uncovered and suggested. I ask both of you all: How is the IRS receiving these thoughts? Are they implementing some of your recommendations? And, maybe, what do you see as the most immediate that they can do to really help in this 2015 tax season?

Could you start, General George? Just how is that being received? Because you all have really thrown out some pretty good ideas and save a lot of money and be more efficient. Is it working? What do you hear? How are they doing?

Mr. GEORGE. If I may, Mr. Chairman, I have had the privilege, actually, of knowing John Koskinen for almost 20 years. I was staff director of the subcommittee overseeing the transition to the Y2K conversion.

He is a serious, conscientious public servant who realizes the challenges facing one of the most important government entities in the world and, obviously, for this Nation.

He obviously has new responsibilities that the ACA and some extraneous items that he inherited before him, but he is literally willing to call me at home and meet with me at any time to discuss issues that we raise of concern.

We list, as you know, required by the Reports Consolidation Act, a list of the top 10 management challenges. And we listed security as the top management challenge confronting the IRS this year.

He is providing resources to address that, in addition to, obviously, FATCA, in addition to many of the other areas that are confronting the IRS.

So I am not here to advocate for him in terms of additional resources. But, candidly, they are being requested to do a lot more with a lot less. And that is something that, again, needs to be considered.

Mr. CRENSHAW. Do you sense that some of the thoughts that you have outlined to us—are they trying to implement those? Are they pretty receptive to some folks that say, “Here is a better way to run the railroad?”

Mr. GEORGE. Very much so, sir. And, again, not to violate any confidences, but literally—today is Wednesday. So on Monday he

called me at 5 o'clock in the afternoon to indicate that the initial response they had to a recommendation that we made to them to better conduct business—that he reversed—you know, they—the staff pushed back. He changed that view and adopted our recommendation 100 percent.

Mr. CRENSHAW. Great.

Mr. GEORGE. Yeah.

Mr. CRENSHAW. Thank you.

Ms. Olson.

Ms. OLSON. I would second what Mr. George says about the Commissioner. Obviously, I report to him, but I have reported to many commissioners. And this Commissioner has very much an open door and does seek my advice.

I would say about half of our recommendations in our annual report to Congress are adopted by them—they agree to it every year. Now, the problem is the devil is in the details. How do we get them implemented?

And what I see and I continue to see after 14 years in this job is a cultural mindset that really is based on historical practices and it is very difficult to get people to look at data that might show that their assumptions are no longer based in reality. And that is not a problem that is limited to the IRS. It is in any large entity. But with the budget where it is, that becomes a critical problem.

And I have advised the Commissioner and identified for him, as I have in my testimony and in my report, programs that I would say to him to take offline and do basically an audit of those programs to really look at, “What are you doing? How are you selecting cases? How are you getting your false positives? What are you learning from those false positives?” and then come back and say, “Okay. We took this program offline. Didn't bring in a lot of revenue from this program this year. But we can prove through pilots going forward that we are going to put so much less taxpayer burden out there, but be much more effective with the resources that we have.”

And I think there is a lot of low-hanging fruit in the IRS that you can do this with and some more difficult, but they are known and they should be worked on.

Mr. CRENSHAW. Great. Great. Growth and change are difficult at times.

Let me ask one quick question that has to do kind of with this Affordable Care Act because I know that is creating a burden on the IRS.

You know, the Administration delays the employer mandate from time to time. And they have extended the enrollment period, I guess, this year. And they are struggling on the front end of the Affordable Care Act. But I have always had concerns for a long time about the back end that might be even in worse shape.

INCORRECT TAX INFORMATION

And I guess we all saw what happened. The Administration announced that 800,000 low- to moderate-income households were sent incorrect tax information, or these new 1095s, and that is about 20 percent of all the people that receive subsidies under the ACA.

Then I also read that, I think, 50,000 people filed their tax returns based on the wrong information as part of that 800,000.

And then I learned last night that the IRS has already said that they are not going to pursue the collection of any additional taxes from the estimated 50,000 people that already filed a return based on the incorrect information. So I guess the IRS has decided they will just turn a blind eye to that.

So I was just wondering, have you asked about that yet or have they talked to you about that? You know, how do they just ignore this situation? Is that something that you are going to ask about or have asked about?

Mr. GEORGE. This is such recent news, Mr. Chairman. Most definitely we will ask about it. We will inquire about it. But it is so new to me that I do not have any additional information at this time.

Ms. OLSON. I would say that, first, I wasn't consulted in this decision. And so I am still trying to figure out what it means. But the IRS always makes a determination of who it is going to go after, who it doesn't. Unless we want a 100 percent audit rate, we are selecting who we go after.

I do have concerns about equity of the 50,000 who have filed and they are not having to pay back, but the people who haven't filed are going to get corrected 1095-As and their taxes will be adjusted downward. And we have the California folks who have gotten some incorrect information.

And the incorrect information is expected in the first year of any program. We get incorrect information from private businesses all the time. And my office has recommended that there be a de minimis figure so that it doesn't cost more to process a corrected return than it does to recoup the tax from it.

And my understanding is, for many of these 800,000, the actual dollar amount is very minimal and some of them will get refunds. But, still, it raises concerns. And I will be having conversations about that. I only wish I had been able to have those conversations before the decision was made.

Mr. CRENSHAW. I guess that will all be added to the tax gap. But I look forward to hearing what they have to say.

Mr. Serrano, do you have some questions?

IRS BUDGET CUTS

Mr. SERRANO. Thank you, Mr. Chairman.

Mr. George, IRS employees collected over \$3.1 trillion in tax revenue, processed over 242 million returns and other forms, issued \$374 billion in tax refunds during fiscal year 2014, which is really nothing short of amazing when you think about it.

In fiscal year 2014, their budget was \$850 million less than it was in fiscal year 2010. And with the fiscal year 2015 cut of \$346 million, it is now down to 1998 levels when you take into account inflation.

You acknowledge this in your testimony and say that sequestration increased mandates from Congress, and reduced budgets have affected the ability of the IRS to deliver in key areas like enforcement and customer service.

You say in your testimony that—and I quote you—“Budget cuts have resulted in significant declines in the performance of the IRS collection program.”

Let’s go into more detail about those cuts. You say that, from fiscal year 2010 to 2014, the budget for the Automated Collection System, ACS, operations and field collections were reduced by \$269 million.

Can you explain what ACS is and how those cuts affected it?

And, Ms. Olson, you could also comment on that.

Mr. GEORGE. Well, what we need to keep in mind, sir, any—I have argued throughout my tenure here, if you can make it as easy as possible for the American people to comply with their tax obligations, they will do so.

As you pointed out, with the Earned Income Tax Credit, the instructions are almost 30, if not more, pages. And for most people, whether they are college-educated or not, trying to understand the Tax Code is one of the most difficult challenges that they face.

When you have a system that allows for electronic filing, as I indicated both in my written and oral statement, that assists taxpayers in complying with the Code, and when you have instances, as was pointed out both by Ms. Olson as well as myself, where they are not answering the telephones, where they are closing Taxpayer Assistance Centers and the like, it makes it more difficult for people who either do not have the resources or the ability, meaning a lot of senior citizens, to go to an H&R Block or what have you.

So the point being is we need to ensure that the IRS, again, applies the limited resources that they have to providing assistance to taxpayers and, secondly, that they are getting accurate information. As you may recall, we have done examinations in the past which showed, at some points, almost half of answers to the questions that taxpayers posed to the IRS by way of a telephone call—to the 800 number, as well as the most available Taxpayer Assistance Centers, were inaccurate. They were wrong.

And then we have tax preparers in the private sector who either intentionally or unintentionally, again, provide incorrect information, the American people overall are harmed because of the reduction in the resources—or revenue, rather, that is collected.

So the bottom line is we need to make sure that the IRS is able to bring on competent people, have, you know, adequate resources in terms of responding to phone calls, but that people can get answers accurately by way of using the irs.gov system. And I am concerned about all of those areas, sir.

The first for us—whenever—and it is very rare now because I do not travel. But when I used to speak to tax preparers, I would implore them, they are the front guard for all of this.

So if someone is seeking a credit for which they are not entitled, these men and women are the ones who, you know, if they are honorable people, should tell that taxpayer, “We cannot and we will not fill that form out for you.” And I am very concerned that that is not happening to the extent that it should.

Ms. OLSON. The Automated Collection System is a centralized call site, and it was originally set up decades ago to be a way in a sort of a production environment to be able to reach out to tax-

payers with relatively modest debts and come up with ways of collecting it.

But over the years what it has turned into is a way of using automated levies, et cetera, to go out and, instead of making outgoing calls to taxpayers and talking through collection alternatives, using a few letters and levies to get the taxpayer to call us. And so you are already in a confrontational environment when you are in ACS.

And our research has shown that, actually, ACS is not very effective in collecting dollars. The most effective way that we have got is actually refund offsets, where a taxpayer gets a refund in a year and we have a debt on the books and we just grab the refund, and then through installment agreements.

And our data has shown that, even as the resources available to Automated Collection System have dropped, that revenue collected through collection has remained stable, inflation-adjusted.

And what we think is the most effective way is if the IRS could get to those cases early when the dollars are low and then continue to both send letters, like a credit card company does, to taxpayers, but also make some outgoing calls to talk the taxpayer through their collection alternatives, get them in an installment agreement, get it to be a debit agreement from their checking account so it is automatic, and then get them, even more importantly, on the road to future compliance. That should be our focus. Go and sin no more.

But this is one of those areas where I have not been able to make headway with the IRS to really review this perceived wisdom that ACS is cost-effective. I think it is not cost-effective. It brings in some money, but it causes problems for taxpayers later on. And we are not working the right cases in ACS either. So that is my assessment.

Mr. GEORGE. And if I may just add, Congressman, it is so much more inefficient and costly for the IRS to collect money once it is out the door.

They have to do a cost-benefit analysis, and they have elected, for the most part, to—and whether it is right or wrong—since it is going to be more costly for us to collect X amount of money from a taxpayer, let it go.

Mr. SERRANO. Right.

Mr. Chairman, can I ask one more question?

Mr. CRENSHAW. Sure.

AFFORDABLE CARE ACT FUNDING

Mr. SERRANO. You know, on one hand, we hear that record numbers of people are signing up through the Affordable Care Act, and that is a good thing. Yet, there are still many people in both houses who would like it to disappear and others would like it to disappear not off the books, but by defunding it or not funding it properly.

So my question to you may sound like the simplest question or a set-up question. What could go wrong if we do not fund properly the Affordable Care Act? I mean, it is the law of the land. It has been, you know, commented on by the Supreme Court. It is not going to go away.

What do we do if it doesn't get—what happens to it—if we begin to talk about bad news where people can't sign up or get hurt, what happens? I mean, we talk about it, but people really haven't analyzed what the full effect would be.

Ms. OLSON. Well, I think you are seeing some of what could go wrong by not funding it with the 43 percent level of service on the phones and a 70, 75 percent over-age percentage on correspondence, where correspondence that the IRS gets they can't get through in their timeframes and so taxpayers do not get responses.

I have thought a lot about the Affordable Care Act and the administration of it in the IRS, and there are some actual positive things from it. This is the one program where we actually get information returns, like Mr. George was talking about, early in the process and we can use them as we match these returns.

And so, in some ways, the IRS has been able to use the work that it has done on the Affordable Care Act to create a model for what we should be doing once we get the legislative authority to receive other information returns earlier in the process and can, as Mr. George says, prevent dollars from going out the door that shouldn't. And I think the ACA has really helped us, you know, get there. We are doing that with the Affordable Care Act.

You know, one thing I have really thought about is that I am very—I am not a healthcare analyst, but I am a practical tax lawyer and I think that aligning the sign-up period with the actual filing season. If you are really going to run this through the Tax Code, it makes sense. If taxpayers are going to get a penalty, they see that impact between now and April 15, and that might drive their behavior to sign up the next year. And having that sign-up period not aligned with it doesn't make sense from a behavioral perspective. And that is one thing I have thought about.

Mr. GEORGE. And I would just add, sir, that, one, obviously, this is unprecedented in terms of the history of this country. And from the perspective, as I view it, of the IRS, they have invested a lot of money, a lot of energy, into this. And so it would be a waste to the IRS if it is repealed.

Ms. OLSON. The other thing that has happened, if I might add this, is that a lot of IT projects, small information technology projects, that would be good for taxpayers have been put on hold because the IRS has a limited IT staff and they are focusing on the Affordable Care Act and FATCA. And that has had impact to the taxpayers. It increased burden on taxpayers for delayed initiatives that would minimize burden on taxpayers in other areas.

Mr. SERRANO. Well, I thank you for your testimony. And, of course, as the chairman said before, I thank you for being here today and for the work you do and your service.

Mr. CRENSHAW. Thank you.

Mr. Graves.

Mr. GRAVES. Thank you, Mr. Chairman.

Mr. George, good to see you again.

Mr. GEORGE. Morning, sir.

ID THEFT AND TAX FRAUD

Mr. GRAVES. Mr. George, I saw in your testimony comments about identification fraud and wanted to talk about that just for a little bit.

You indicated in your testimony that it totals about \$5 billion a year, estimated, that is still out there with identity theft.

And just thinking through the process—and I am trying to kind of learn how this happens. Maybe I could just ask some questions and, hopefully, you could help us, as a committee, see through this a little bit.

When is the earliest that one can file his or her taxes in a given year?

Mr. GEORGE. It technically varies, depending upon when the IRS decides to open. I mean, of course, the tax years begins—

Mr. GRAVES. Right.

Mr. GEORGE [continuing]. At the beginning of the calendar year. We are speaking generally because you have corporations, too, that have different—

Mr. GRAVES. I am just speaking of individuals.

Mr. GEORGE. Individuals.

So I believe this year it was the second or third week of January, although last year it was delayed because of funding issues. But, then again—and this is not public—I mean, it is not private information.

But, as I indicated and, I believe, as Ms. Olson indicated, also, people can file before employers or others who are required to report how much money they have reported that information to the IRS, sir.

Mr. GRAVES. So that would be my second question.

So an individual could theoretically, this year, have filed their taxes the second week of January—so we will just pick a date—by the 14th of January.

And when are the W-2s due to be submitted by employers to the IRS?

Mr. GEORGE. I believe it is March. It is March. So yes.

Mr. GRAVES. So there is a period of time, then, in which one can file their taxes and then there is a gap, a delta, until the business owner or the corporation submits their backup data to reconcile that. And this can be done electronically. I assume an individual can file electronically that second week of January.

And then what is the quickest they could get a return, a refund?

Mr. GEORGE. There is a statutory deadline for that.

Ms. OLSON. I think within 4—electronically, there have been some refunds going out within 4 days. But, generally, a week. And if they file on paper, it could take anywhere from 10 to 14 days to even more weeks.

Mr. GRAVES. Okay. Let's stay with electronic, then, for a second.

Ms. OLSON. Yes.

Mr. GRAVES. So 4 to 7 days.

Ms. OLSON. Yeah.

Mr. GRAVES. So on January 14 one who might have somebody else's identity, which could only include a name and a Social Security number, if I am correct, could submit an electronic filing fraud-

ulently and have a return within 7 days without any corresponding information that would reconcile that, and the IRS would deposit that money.

Ms. OLSON. If I could just insert here, the IRS, over the last few years, has been working with some of the largest employers and getting voluntarily their records on the W-2s, for example, before they are required to—we would get them from Social Security.

And so the IRS has built some databases for use during a filing season that we will run returns through to see whether the information reported on them matches. But it is basically asking people a favor.

Mr. GRAVES. I am just trying to get to the \$5 billion in improper payments—

Ms. OLSON. Yes.

Mr. GRAVES [continuing]. That still exists out there and why this occurs.

So electronically one can file a return. All they need is a couple of pieces of data to file a return. The IRS will then, without reconciling it, deposit money onto a debit card, if I understand properly, that could have been purchased at a local retail store, a convenience store, or not even had to be purchased. It could have been given to them without any identification required there as well.

So it sort of creates a system that leads me to ask the question: Can an IP address allow an unlimited amount of returns to be filed through one IP address or are there any governing measures on that? And is it domestic only, or can it—throughout the world can electronic filing occur?

Mr. GEORGE. There is no limit that is received only in the United States. The IRS recently gave people the opportunity to have, you know, multiple accounts receive refunds.

And, sir, I just want to make sure we are clear. It is not even just a Social Security number. An individual taxpayer—what is called an ITIN, an Individual Taxpayer Identification Number, can also be used to file and to receive a refund.

Ms. OLSON. If I could just add here, your statement is correct. The IRS has got filters that would help it identify questionable things, so looking at things from certain IP addresses or the volume coming from IP addresses or the volume of requested deposit refunds into one account or on one debit card or things like that.

So, you know, we have built filters to identify questionable returns. The problem is, no matter how smart the IRS gets, you know, others are out there moving one step ahead of us. And so you are always sort of tracking behind. And that is one way you get to that large, you know, fraud number.

Mr. GRAVES. Right.

A couple more, if I could.

Mr. CRENSHAW. One more.

Mr. GRAVES. One more?

I just have a few questions on my mind about it.

So you mentioned not overseas, though, Mr. George.

Mr. GEORGE. Oh, no.

Mr. GRAVES. Okay. So a filing can occur—

Mr. GEORGE. Yes.

Mr. GRAVES [continuing]. Outside of our country?

Mr. GEORGE. Yes.

Ms. GRAVES. Okay. And multiple filings can occur from one IP address, unless captured by this filter.

And you say with certainty, though, IP addresses or multiple filings through one IP address is monitored and filtered?

Ms. OLSON. Well, I can't discuss specific filters.

Mr. GRAVES. Okay.

Ms. OLSON. But that is something—

Mr. GRAVES. I thought you just did. I'm sorry.

Ms. OLSON [continuing]. That anybody would raise questions about.

But I will note preparers legitimately have an IP address that they would be preparing multiple returns through. So—

Mr. GRAVES. Preparers who put their name on the form.

Ms. OLSON. On the return. Right.

Mr. GRAVES. Right.

But I am speaking of those who do not.

Ms. OLSON. Right. That would not. That is correct.

Mr. GRAVES. So I would like to clarify that.

Ms. OLSON. And that would raise eyebrows.

Mr. GRAVES. And then might I ask, Do you know how many filings do occur during this period where there is that delta in which one can file a return and which the corresponding data that would reconcile that is filed as well? Is there a number that might correspond there?

Mr. GEORGE. I am going to give you a chance.

Ms. OLSON. Well, I think there are two peaks in our filing season. And so one would be just right out of the gate for, like, the first 2 or 3 weeks. And that is in your delta period. Right from the start of the filing season to about 3 weeks into it, people rush to get their refunds.

And then the second peak is at the very end, when everybody is like, "Okay. Now I owe money and I have got to meet this deadline." So your problem is in the delta.

And if I could just make one point here, one thing that I have recommended in the past—and it is difficult—is not only moving up the dates for us getting that 1099 and W-2 information, but some countries around the world and some States actually do not pay out refunds until after the end of the filing season.

So they have, "File your returns from this date to this date." And then there is a pause for like a month and a half while the tax agency is able to sort through all this stuff so they can see, "Oh, we have got two returns coming in from this Social Security number" or, "Two people are claiming the same child as a dependent."

And you have that period to sort out before you are paying any refunds. And then they start paying refunds after a certain date. That is really changing the culture in our country, but it is one way that other countries have been able to combat fraud, to have that pause.

Mr. GEORGE. Okay. And if I just may say, I find it appalling, Congressman, when the message from the IRS is, "File early so that the criminals can't take advantage of you."

That is extremely troubling. And it may be common sense, again, with resource limitations and what have you, but I am actually very shocked and disappointed by that message.

Mr. GRAVES. Thank you.

Mr. Chairman, might I note for the committee that the \$5 billion in identity theft that the General has pointed out is nearly half of the entire IRS budget for one year.

Mr. CRENSHAW. Yeah. That is quite a number. General George, I can remember when that question was asked, "How do we prevent this fraud?" and the answer was, "File early." We have got to do better than that.

Mr. Amodei.

Mr. AMODEI. Thanks, Mr. Chairman.

And thank you both for the briefing.

Ms. Olson, I am trying to get a sense for—I mean, I hear the part about budget cuts and resource allocation. I am trying to get a sense—the IRS has been cut 17 percent.

TAXPAYER ADVOCATE BUDGET

Can you give me a feel for what your operation has been cut? Has it been 17? More? Less?

Ms. OLSON. My operation this year—you all were very kind to my operation and sustained us and actually gave us a little bit more.

And I can only think that the thinking was that, since we are the safety valve for the IRS, that when the IRS isn't meeting taxpayer needs, there are more taxpayers with significant hardship, and that means they come to us. And, in fact, our cases have increased by 6 percent so far this year over the year before. We are seeing that.

TAXPAYER ADVOCATE CLIENTELE

Mr. AMODEI. And then can you give me a profile of the folks that kind of hit in the middle of the driveway that you help.

And let me tell you why I am asking the question. Because I know there are statistics out there that the top 10 percent of the population pays X amount of the tax, but it is a large amount.

So I would assume, in any organization, when you are, as you should be, pursuing collections, that you go to where those collections are the most in need of pursuit.

So I am assuming that the Warren Buffets and the Bill Gates of the world aren't calling you up and saying, "Hey, what do I do on my Schedule"—blah, blah. It is most of those folks who probably fall into however it breaks down.

Can you give me an idea of who it is, the demographic or where on that rainbow those folks fall that you are serving.

Ms. OLSON. Yeah. You know, it is really interesting. We definitely get low- or middle-income working families and then small businesses coming in.

Now, we are always getting—there is always some large business that can't get an issue resolved. It is usually an account issue that can't get resolved because they are talking to a different person each time they call and then they end up.

But the bulk of our cases, you know, 90 percent of our cases, are middle-income, low-income working folks and small businesses who are having problems with the IRS. And those problems can range from collection problems to earned income tax credit problems to other audit problems, account problems.

And certainly identity theft has been for the last 3 or 4 years the largest portion of our case receipts each year, going anywhere from 20 percent to 27 percent of our case receipts in any given year. That is thousands and thousands of identity theft cases.

Mr. AMODEI. So you are serving—if these aren't your words, do not adopt them.

But you are serving predominantly people who represent, generally, what portion of income to the IRS—

Ms. OLSON. We have actually never really done—

Mr. AMODEI [continuing]. Percentage-wise?

Ms. OLSON [continuing]. An income thing. But I would say, you know, middle to low income and, again, small business—very small business, sole proprietors.

Mr. AMODEI. Okay. Would it be possible, if you had some time, to—

Ms. OLSON. Yes. Absolutely.

Mr. AMODEI. Okay.

Ms. OLSON. We could pull a sample of our population and look at their most recent returns.

Mr. AMODEI. Okay.

Ms. OLSON. I would be glad to give that to you.

Mr. AMODEI. Thank you.

I yield back, Mr. Chairman.

Mr. CRENSHAW. Thank you.

Mr. Yoder.

CONSTITUTIONAL RIGHTS

Mr. YODER. Thank you, Mr. Chairman.

Inspector George, welcome to the committee.

Ms. Olson, thank you for being here today.

I note in your testimony, Ms. Olson, your comments regarding the culture at the IRS. And I think it is a concern that has grown from a concern to an outrage amongst Americans in the country and the lack of trust between the citizens and their Government, and a lot of it stems from the abuse of that trust by the IRS.

And I note certainly the ongoing abusive practices related to—or at least the—hopefully, not ongoing abusive practices related to targets and auditing and harassing of Americans based upon their free speech rights and their engagement in standing up for their beliefs, that they might be targeted by the taxing entity in the United States.

I note that in recent years there have been reports of the IRS reading the private emails of Americans without a warrant in violation of their Fourth Amendment rights, and the IRS's response—or their position was, "Americans do not have an expectation of privacy in their email accounts." Americans do, and they disagree.

I note the presence of Congressman Roskam, who has been very outspoken on this issue, that in recent weeks there have been much light shed on the fact that the IRS has been seizing the as-

sets of Americans without due process, without any crime required, without any allegations, without any representation.

This is more than a culture. This is an agency that has destroyed the trust between it and the American people, believes it is above the law, and believes it can ignore the Constitutional rights of Americans.

And it is just a wonder every day to pick up the newspaper and read about what Constitutional rights are being violated by the IRS, whether it is the First Amendment, the Fourth Amendment, the Fifth Amendment.

It is beyond a culture. It is a broken agency. And maybe it is time to consider wholesale change. Maybe it is time to consider the Fair Tax. Maybe it is time to consider something completely different. Because what is happening at the IRS is not working, and Americans are outraged.

And so I look towards the Inspector General and Ms. Olson for your ideas. But I note that there has been many throughout history who have noted that the power to tax is the power to destroy. And that is what is happening in this country today, and American are outraged.

And I want to know what the—Inspector General, Ms. Olson, what you think should be done and how we correct these abuses of Americans' freedom and Constitutional rights?

Mr. GEORGE. Go ahead, please.

Ms. OLSON. All right, well, I think there is a lot in your statement. I too share the concerns about the civil asset forfeiture, and I think some of the oversight that this Congress is doing on that, and looking at the due process protections that may need to be added to that process, are very important. I think that in terms of the culture, I make a distinction. I think in each of the instances that you have raised, it is a very small portion of the 90,000 IRS employees who are involved in that. And I think there we really need to look at those actions and see what more would need to be done. I will also note that the IRS adopted, after I had recommended it for years, in June, a Taxpayer Bill of Rights. And among those rights are the right to privacy, the right to confidentiality, the right to a fair and just tax system.

And you know, Mr. Roskam, and this House passed it last summer, and I believe there will be some action this year. And I have recommended that you actually codify that, and hold the Commissioner accountable for making sure that those rights are worked and honored in every aspect of tax administration. And frankly, only then will you get back the trust of the American taxpayer.

Mr. GEORGE. And I would simply add, sir, I think that you were quoting Lord Acton about the power to tax being the power to destroy. There is no question at all, that that resonates with people. I, again, although I should have prefaced my statement by saying, since President Reagan's administration, sir, the Secretary of the Treasury has issued a directive—to discuss tax policy for the Department of the Treasury. It has given sole authority to the Assistant Secretary for Tax Policy, so I need to adhere to that. The bottom line is, it has to be fair. People have to know that they are being treated respectfully. And I will note this because, again, I was a staffer on Capitol Hill, when the IRS Restructuring and Re-

form Act was passed which created TIGTA, and I don't know whether—

Ms. OLSON. And my office.

Mr. GEORGE. And Ms. Olson's office. So it seems that periodically, the IRS experiences this period where things are amiss, and I am not sure, sir, whether you were here or not, but I earlier, again, gave a lot of credit to the current Commissioner who is an extraordinarily experienced executive and who is taking these matters quite seriously, and I think will hopefully have a positive impact on the workings of the IRS.

Mr. YODER. Well, I appreciate your response. There is a lot of work to be done here and I think beyond just a bill of rights, I think there need to be wholesale changes of how we operate the IRS and maybe looking at complete reform, things like the Fair Tax.

EITC IMPROPER PAYMENTS

I do want to ask one other question, Mr. Chairman, thanks for a little more time here, to just ask about the Earned Income Tax Credit. It now ranges in fraud or misapplied payments in the amount of \$16- to \$19 billion. It is 24 to 29 percent of the entire program. And I think about some of the priorities I have in Congress, helping educate young children through Head Start. We spend \$9 billion on that; NIH funding, we spend \$31 billion on that. The ability to invest in things that matter to this country by those lost dollars and the impact it has on children, or cancer research, I think is heartbreaking, and it also speaks the inability of the IRS to solve this problem because it goes on year after year.

We have been working on trying to get to the heart of what causes this, and we see that there is a rise in the misapplied payments and the fraud from folks who file on their own, don't file through a preparer, and there are different standards that are applied in those cases. And so I guess my question would be, do you believe that tax filers make when online self-filing, that those certifications are best designed to prevent fraud and prevent improper payments? Do you have any further suggestions for eliminating improper payments across the board? And what are the consequences for knowingly filing and EITC certification via a paid preparer? Are they the same as falsifying online self-preparation?

Mr. GEORGE. Again, sir, I don't recall whether you were here. The instructions for filing the Earned Income Tax Credit are extraordinarily complicated. And so, obviously, if somebody wants to commit fraud—we have a voluntary compliance system, so if someone wants to cheat on their taxes, unless you required third-party reporting on everything that anyone earns, people will be able to do so. The key, of course, would be for the IRS to make examples of people who are caught having cheated on any aspect of their tax return. That, obviously, practically cannot work because of the millions of people involved and the billions of dollars involved.

I will say this: For over 20 years, the Earned Income Tax Credit has been one of the most abused credits in the tax system. And while some progress was made at one point, not enough has been done. And the Commissioner knows this, Congress knows this. So I—again, unless you are going to start arresting people and pros-

ecuting and parading them in front of cameras, I really don't have a definitive answer for you.

Ms. OLSON. Could I make a comment about that? I think that there are multiple sources of error and fraud in the Earned Income Tax Credit. And I have—I owned a tax practice when the Earned Income Tax Credit was enacted, so I sort of feel like we are good buddies from 1975 on. I have wondered about that decline in preparer prepared returns, and I think really there are preparers involved. They are just no longer signing them. And that might go to an IP address thing. Can you find out whether you are getting a number of these returns from one address, or going into one bank account?

But preparer regulation for this unenrolled population is going to be huge. Because if you can deal with a preparer strategy, if you can deal with one preparer who is doing bad returns, you are not going just one taxpayer by one taxpayer, you are getting the whole bunch of those returns. The other thing is, we have made legislative recommendations for changing the statute itself that might help minimize some of the opportunity for fraud. And the third thing that I would say, we have done research that shows that the IRS is actually not auditing the right issue when they are doing their audits of EITC. They are not auditing the issue that actually our own—the IRS's own research has shown has the most dollars associated with it. So they are sort of going after the lowest hanging and easiest fruit rather than the area where you might be able to move the dial on improper payments. And those are just three things that I would comment on.

Mr. YODER. Thank you. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you, and also, I remind the members that the Commissioner will be coming before the subcommittee and a lot of these questions can be directed to him. I think for those that missed the opening statement, I think Ms. Olson and Inspector George really brought out some of the things that they are working on in ways to improve and that is kind of their job, and we appreciate that very much. Let's go to Ms. Herrera Beutler.

Ms. HERRERA BEUTLER. Thank you, Mr. Chairman. And I apologize. I had—it is like the constituent visit time, on top of hearing time. So multiple places at once. So I apologize. I have a couple of questions and I find this horribly fascinating. It is terrifying to me that this is what we are having to deal with and work through. I mean, each one of the issues raised is a giant tragedy of a play unto itself. So I thank you both for the work that you are doing.

S CORPORATIONS

Mr. George, you estimate that in the 2013 season, as much as \$2.3 billion were erroneously given to corporations in carryforward credits. However, the IRS doesn't plan, as best I can tell, to follow your recommendations to address it. We have talked a little bit about that. And then you went on to say that the IRS is dedicating significant resources toward addressing what it believes is the most significant risk to compliance, the use of flow-through entities, such as partnerships. Flow-through entities, S corporations, from my experience, and just in my region, in my district, are the small family-owned businesses. In fact, I got to tour one this last week. And

obviously, some of the biggest users of carryforward credits are giant corporations, publicly traded. Correct?

Mr. GEORGE. Yes.

Ms. HERRERA BEUTLER. Do you have any idea why the IRS is ignoring that \$2.3 billion? I mean, as we were talking about NIH funding, and cancer funding, and all of these other things, it is hard to understand their priorities here.

Mr. GEORGE. And please, I hate to punt here, but that is a policy question, Congresswoman. And I am going to have to defer on that one.

REHIRING FORMER EMPLOYEES

Ms. HERRERA BEUTLER. Okay. Okay. Well, we look forward to the Commissioner joining us. Let me switch. I actually have a couple more questions for you, if that is okay. Your testimony highlights several of the shocking behaviors. We have been talking about it all morning. Most notably to me is that the IRS is rehiring those that it fired, those specific employees who were, I feel, acting as predators. They are supposed to be protecting and at the very least adhering to the law, but in many cases were selling folks out.

Help us understand the IRS' response to this, and possibly how we could, I mean, we have brought—this committee has brought this up to the Commissioner in years past. How do we make a dent here?

Mr. GEORGE. Again, Congresswoman, before you arrived, I pointed out the fact that the Commissioner, John Koskinen and I speak, if not every day, every other day. And while I don't want to steal his thunder on this very issue, he called me Monday and issued to me a statement about the fact that they saw the report and while initially his staff pushed back, it is part of, again, what occurred under the Restructuring and Reform Act of 1998, which issued a listing of things that if IRS employees did or violated, they were subject to everything from just, you know, excuse me admonition to removal.

[The information follows:]

"The report that Commissioner Koskinen called about, where his staff initially pushed back, was not the report on rehiring employees with prior performance and conduct issues. Instead, it was about a report that we will be issuing shortly on IRS employee tax compliance."

And so to make a long story short, they are going to change their policies as it relates to that and I think at his appearance before this committee, you know, he will make a formal statement as to what those changes are. Obviously, it is—it was, you know, repellent that they would allow people who were accused of engaging in the behavior that we identified, were able to be rehired. A lot of these people were seasonal people. As you may know, during the filing season, the IRS hires tens of thousands of people to help process tax returns, and the bulk of the people that we identified in that report were in that pool.

And now, in all candor, you know, he has to make some choices because if he can't hire 30,000 people, they can't process tax returns unless everyone files electronically. But, and then there are some instances—I mean, you are innocent until proven guilty. If you are accused of a tax violation, you have the right to appeal it

and some people win their appeals. So you have to be fair to people, and yet, at the same time, just the appearance.

Ms. HERRERA BEUTLER. Well, and I think that is it. When we were talking about credibility here, this at the IRS has to be above reproach. It is not—there are so many reasons, and so I think if it takes more time and effort to make sure they get it right, it is worth it.

Mr. GEORGE. I agree.

Ms. HERRERA BEUTLER. Thank you. I yield back.

Mr. CRENSHAW. Thank you. I would like to now recognize one of the new members of the subcommittee, Mr. Rigell, who is from Virginia.

Mr. RIGELL. Thank you, Mr. Chairman and I am delighted to be here. And like some of the other members, my preference would have been, of course, to have been here from the very beginning, but the schedule just didn't permit that. So if what I ask, if there is a bit of redundancy here, I apologize in advance for it. But this is an important topic and I thank you both for being here and for your service. I do.

CUSTOMER SERVICE

I was raised by a NASA engineer, and so this idea of how we view the Federal employee to me is very important, I see as fellow Americans trying to do the right thing. Now, that said, we are in a tough spot here with the IRS on multiple levels. And I would like to draw your attention, Inspector George, to the first, really the first contact that a taxpayer can have with the IRS, and a hard-working American trying to get it right, trying to pay his or her taxes, trying to get guidance on this. And you know where I am going with this. The trends are just not good in terms of response time. We are heading in the wrong direction, and it is a serious thing. You get to where you are on hold for 30 minutes. This is very discouraging, and it does breed a lack of confidence, if not contempt, you know, for the agency. So if you would, in a concise way as you can, try to explain, to help me to understand why that is the case, and we will see where we are going with the follow-up question.

Mr. GEORGE. It is resources, sir.

Mr. RIGELL. Okay, I thought so. Let me ask you this: This is something that I think is really important here. And I don't go to work every day at the IRS, clearly. But it seems like there is this consistent pattern of it is always more money. Now, if you could provide some objective metric, some table that shows, you know, cost per call, the number of applications or tax returns that have been filed on the ratio of the number of IRS employees, for example; you could show some linkage here, I would be more open to the argument. But what has to happen certainly in the private sector, and I think it must happen in the public sector, is this belief that productivity and increased customer service are not mutually exclusive. And if the leaders themselves don't believe that, then there is no way the organization is going to move in that direction. So if you would, please, address that whole mindset that it is not always more resources. Help me to understand your view on that.

Mr. GEORGE. Sir, and I beg the chairman's indulgence—because he has heard me, I think, recite the following. You haven't, but—

Mr. RIGELL. Okay, thank you for your patience and saying it to me.

Mr. GEORGE. Well, but this is so important.

Mr. RIGELL. All right.

Mr. GEORGE. It is called third-party reporting, sir. There is a high correlation between tax compliance and third-party information reporting and withholding. The IRS itself estimates individuals whose wages are subject to self-reporting—withholding, rather—so reporting by a third party—report 99 percent of their wages. So if a business or you know, anyone else reports to the IRS—

Mr. RIGELL. Right.

Mr. GEORGE [continuing]. We pay, you know, Russell George, you know, \$100, you will get 100 percent from me, but 99 percent from most people.

Mr. RIGELL. There you go. For the record. Okay.

Mr. GEORGE. Now, self-employed individuals who operate non-farm businesses are estimated to report only 68 percent of their income for tax purposes. So again, these are people who are not given—that information is not given to the IRS, at all, and they are estimated to report only a little more than two-thirds. But here is the most, I think, shocking figure. Self-employed individuals who operate businesses on a cash basis are estimated to report only 19 percent.

Mr. RIGELL. The numbers don't surprise me. And let me pivot back though for a moment, because I know you are trying to answer my question. But I think we passed each other on this. Because what I was seeking clarification on is the culture, the ethos, the mindset of the senior leadership within the IRS, that productivity and increased customer service to the taxpayer are not mutually exclusive. That is, that with the same number of staff or the same amount of resources, that if we maybe have a different workflow, we leverage technology, that we can have both, increased productivity. We can reduce the amount of time it takes to answer a call, which is now—well, less than half are being, you know, to where the taxpayer is actually speaking to the representative, and then they are on hold waiting for that for about 30 minutes. So I don't think you answered that part. And I don't see that my clock is winding down so I am not exactly sure how the time works here on the committee yet, but the chairman will remind me.

Mr. CRENSHAW. Well, you are almost out of time.

Mr. RIGELL. I imagine.

Ms. OLSON. May I attempt to answer that?

Mr. RIGELL. Please. That is really, to me, we are in an area and a time of increasing austerity, principally because healthcare cost, and that is just a whole other subject. But we are going to have compression on the rest of the budget into perpetuity because of mandatory spending, defense, transportation, education, and on agencies like the IRS. So this mindset of getting more and having higher productivity has got to be part of how we think.

Ms. OLSON. I think that the IRS leadership is actively working on a concept of operations for the years to come that will incorporate online taxpayer accounts, so that taxpayers can see what is

going on. They can communicate with the IRS electronically. They can send documents to the IRS, trying to drive some of the traffic on the phones over to the electronic environment. And I think that will then leave—that will then allow the resources on the phones to be able to address the issues that people really need to talk to somebody about.

Mr. RIGELL. Ms. Olson, just out of respect for the Chairman, I think he is about to hit the button. But I just wanted to tell you, I thank you both. My parting thought is that this idea of increasing productivity and simultaneously increasing response rates, if the leaders themselves don't believe it, it will never happen. And so I just want to be sure that that message is dispersed to the extent that it can be. I thank the chairman, and yield back.

Mr. CRENSHAW. Thank you. Yeah, we have taken a little liberty with the clock today and I think everybody has had a chance to ask as many questions as they might want. I know Mr. Serrano has another question.

Mr. SERRANO. Well, let me first turn to our new colleague that what the chairman is doing, he had an eraser, and he was just erasing things he had written on the wall there. And—you know, Crenshaw was here, that kind of thing.

On a lighter level, I just read where Floyd Mayweather and Manny Pacquiao are going to make close to \$250 million. I think the IRS is going to have with that and Pay-Per-View with HBO and Showtime. I think there will be a little income coming into the Nation's Treasury. I wish I knew what percentages they pay for that kind of money, you know, and does Manny have to pay in the Philippines, and do we have an arrangement with that. But I will ask the Commissioner that.

TAX EXEMPT AND GOVERNMENT ENTITIES

Let me just talk to you about the EO unit, and follow up on some of the questions that were asked before. That was an area, believe it or not, where we saw bipartisan outrage, and there was a discussion about whether one side was targeted and another side was targeted. It didn't matter. We felt both sides were targeted. On this side we felt both sides were targeted. And we didn't like it. And now your testimony says that changes have taken place in that unit. Then we hear that we are rehiring some people that might have been part of the problem.

So my question to both of you is: What changes have taken place? Should the American people and the Congress feel more confident that this will not happen again, or certainly, you know, can be prevented in the future because it was embarrassing to everyone? And like I said, it was a bipartisan outrage. It wasn't, you know, us against them or them against us. And secondly, budget cuts. Are there now enough people in that unit to be able to take care of the changes that need to be made?

Mr. GEORGE. As to the second question, sir, I will have to defer—defer, rather, to the Commissioner. He needs to—I don't know the answer to that question.

As to your first question, the IRS has agreed to every one of the recommendations that we issued in that report which preceded his arrival, out of fairness to him. We are in the process now of vali-

dating whether or not that is actually the case. We also made a commitment to Mr. Cummings, and I informed then-Chairman Issa, of the fact that we were going to and we are in the process of looking at how the IRS treated groups that were not related to Tea Party, Patriot, and the other groups that were identified initially by the IRS as being part of the groups they had, you know, I am going to use the word targeted now just as because you used it, but that is not the word we used.

I cannot—we are human beings, sir. So you can have every rule in the world, and if someone wants to disregard the rule, they can. And again, with the IRS, ranging from 80-plus-thousand, to at its height, 100-plus-thousand, there are bad apples everywhere. So I cannot sit here and, you know, before Congress say that nothing could ever reoccur.

Mr. SERRANO. Right.

Mr. GEORGE. But you know, I think in this environment, you know, you are dealing with some smart people now at the head of that organization. And I am optimistic that they will avoid a repeat of this type of behavior.

Mr. SERRANO. Well, I think that statement is a good one. I mean, I don't expect you to, of course, say you know, what human nature will be like, or human behavior will be like. But if you in your position feel that it has tightened up, that there are people trying to make sure it doesn't happen again, that certainly is satisfactory to me. I don't know if it is to other members of the committee. Like you say, you can't judge what people will do. I mean, you can certainly put in place rules that make it harder for them to practice it or to do it. Ms. Olson.

Ms. OLSON. Well, I view what had happened, and I say this not trying to minimize it, as really managerial malpractice; that there was a lack of serious attention and assistance being given to the frontline employees who were trying to get answers. And that is why entities that were selected and targeted did not get action on them. And those kinds of managerial failures have been corrected. There are processes in place for review and getting answers and information that didn't exist when all of that was going on.

I would say that right now, what is happening with the returns is that the IRS has changed the rules saying all you have to do is attest that a certain percentage of your activity will not be, or will not be put, to political activity, electioneering, and you are fine. And then they are going to rely on audits on the back end to see if they have got any abuses there. And so we are not really out of the woods here yet because we don't know how they are going to be auditing these entities, what they are going to think is an abuse later on. And that brings us back to: I really do believe that Congress needs to act to give a little bit better definition and guidance to the IRS about what constitutes political activity and what is the incorrect or the untolerated level of political activity.

I have made a legislative recommendation in my report to Congress this year about that, and I think that will help enormously. But I do think we will have to see how the IRS selects entities for audit before we can say, you know, where we are on this.

Mr. SERRANO. Thank you. Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you, Mr. Serrano, and I thank everyone. I have got some more questions, but I will submit them to the record, and I know others as well. But let me again thank you all for being here, because I know you have got a tough job. As you stated your testimony, there are things that you are doing to try to help us. We are all trying to help the IRS even though the IRS has never been one of the most endearing agencies to most people in America. And it seems like when we started all this, when Commissioner Werfel was the new guy, and I asked him, I said, do you think the IRS has betrayed the trust of the American people? He said yes. I think there is a lot that goes into restoring that trust, and quite frankly, I don't think complaining about the lack of money, or not answering the telephone, or things like that, is the best way to restore trust. But I do think the things that you all have come up with, the recommendations that you see every day, if the Commissioner were to implement those, I think it will help. The Commissioner is going to come before us, and we will have a lot of questions for him. But you have done a great job, a great service, in the work that you do to let us know your view of the world as it relates to the IRS. We want to do a better job and ultimately we want the IRS to do a better job. So again, thank you for being here today. This meeting is adjourned.

Mr. GEORGE. Thank you, sir.

Financial Services and General Government Subcommittee
Hearing on Internal Revenue Service Oversight
for Treasury Inspector General for Tax Administration
J. Russell George

Questions for the Record Submitted by Chairman Crenshaw

Civil Seizures

Earlier this month, the House Ways and Means Subcommittee on Oversight held a hearing about IRS civil seizures as a result of structured payments. Chairman Roskam is deeply concerned that the IRS is using its authority to disrupt and destroy law-abiding, small businesses instead of criminal enterprises. The IRS Commissioner assured him that the IRS is changing its policies to only pursue cases that have a criminal connection.

Question: Is TIGTA planning to review the IRS' civil seizure program this year?

TIGTA has recently initiated an audit to evaluate the IRS's application of civil seizures for use against taxpayers suspected of transaction structuring to avoid the Bank Secrecy Act reporting threshold. We plan to review cases in which the IRS seized accounts related to allegations of structuring and to interview Criminal Investigation executives and managers responsible for oversight, as well as personnel responsible for conducting these types of seizures. In addition, we will evaluate current and past IRS policies, procedures, and guidance, as well as the legal requirements for seizures made based on potential transaction structuring. We will also determine the impact these seizures had on taxpayers through data analyses and case reviews.

Sunk Costs

During the hearing, you testified that the IRS had invested a lot of money and energy into the Affordable Care Act (ACA) and that it would be a waste to the IRS if it is repeal.

Question: How much money has the IRS spent since FY 2010 on the enactment of the ACA?

According to the IRS, it has spent \$1.6 billion to fund ACA-related initiatives from FY 2010 through FY 2015. The IRS's FY 2016 budget request includes additional funding of \$490 million to fund 2,539 FTEs for continued efforts related to the implementation of ACA.

Question: Are sunk costs a reason to continue a project or program?

Sunk costs are only one consideration when evaluating the continued viability of a project or program and should not be the sole or major determination. Management must also consider statutory requirements and the overall benefits expected or achieved from a project or program when making informed decisions concerning continued development or operation.

The IRS spent roughly \$2.5 billion on a failed tax system modernization effort in the 1990's. More recently, the IRS estimated that it would launch a new fraud detection system in 2012 at the cost of \$57 million. After spending \$144 million, the IRS delivered a very small fraction of the system's expected functionality in 2014 and has since stopped work on the system.

Question: Given the sunk costs of these two projects, should the IRS have continued with them?

TIGTA believes that continued work on the Return Review Program and CADE 2, the major project of the IRS's Modernization Program, is warranted. These projects, if completed as planned, have the potential to achieve a benefit equal to or exceeding the total cost of the program. Benefits can be defined in monetary terms, cost savings, replacement costs, improved customer service, or efficiencies gained. In the case of the Return Review Program, the benefits projected would significantly reduce fraudulent refunds, saving billions of dollars. CADE 2 is the IRS's replacement system for the Individual Master File, which is over 40 years old and uses Assembler and Cobol programming that is difficult to maintain and not efficient. TIGTA believes that the Return Review Program and the Modernization Program are both critical programs that need to be funded and completed. We are currently reviewing the Return Review Program, including the results of the controlled launch conducted in 2014. The small fraction of the system's expected functionality that was deployed in 2014 identified significantly more potentially fraudulent returns than the existing Electronic Fraud Detection System, thereby demonstrating the system's potential. The Return Review Program is currently in a strategic pause to allow the IRS time to evaluate the performance and design of its parallel processing databases and to revisit strategic business fraud detection goals.

Questions for the Record Submitted by Congressman Mike Quigley

Same Sex Marriage Filing

After DOMA was struck down by the Supreme Court in 2013, married same-sex couples had the ability to file federal taxes together for the first time during the last filing period.

Question: Following this incredibly significant change in federal law, are you aware of any significant implementation issues and, if so, what do you think the IRS must do to address these issues?

In September 2014, we reported that the IRS accurately implemented computer programming that allowed married couples of the same sex to file as married filing jointly.¹ Our analysis of tax returns processed through May 8, 2014, found that married couples of the same sex were successfully able to file as married filing jointly.

¹ TIGTA, Ref. No. 2014-40-077, *Key Tax Provisions Were Implemented Correctly for the 2014 Filing Season* (Sept. 2014).

Question: What has the IRS done to educate taxpayers about this change and what resources have you provided, or plan to provide, for same-sex marriage filers during this transition?

The IRS has used various outreach activities to inform taxpayers and tax preparers of the changes allowing same sex couples to file as married filing jointly. For example, the IRS has issued press releases and provided online products on IRS.gov, including informational videos and frequently asked questions. The IRS also included a session in its 2014 Nationwide Tax Forums on the Defense of Marriage Act and the changes that allow same sex couples to file as married filing jointly. The Nationwide Tax Forums are conducted by the IRS to share information with tax return preparers.

Identity Fraud

I was shocked to read in a recent GAO report that the IRS is estimated to have paid out \$5.8 billion in fraudulent refunds last year. That's an increase of over 60 percent since 2011.

Question: What would you attribute to this increase?

At this time, we have not performed any audit work to validate the \$5.8 billion figure cited by the IRS related to identity theft fraud. However, we are planning to initiate an audit later this fiscal year of the IRS's office that prepared this estimate. The IRS acknowledges that it has used estimates and averages to compute portions of this figure and it is continuing to review new data sources to make improvements to its processes for its estimate.

Question: What is the IRS doing to adapt to the evolving challenges of identity theft and in your opinion, do you think we can get in front of this issue without additional investments in IT?

The IRS recognizes that new identity theft patterns are constantly evolving and, as such, it needs to continue to adapt its detection and prevention processes. Consequently, the IRS continues to expand its filters used to detect identity theft refund fraud at the time tax returns are processed. For example, the IRS used 11 filters in Processing Year 2012 to detect approximately 325,000 tax returns that prevented the issuance of approximately \$2.2 billion in fraudulent tax refunds. In Processing Year 2014 as of September 30, 2014, the IRS increased its filters to 114 and detected 832,412 tax returns, preventing the issuance of approximately \$5.5 billion in fraudulent tax refunds. The IRS has increased the number of filters to 196 for Processing Year 2015.

In addition, the IRS continues to expand the locking of tax accounts which results in the rejection of an electronically filed (e-filed) tax return (*i.e.*, the IRS will not accept the tax return for processing). A locked tax account also prevents paper-filed tax returns from posting to the Master File if the Social Security Number associated with the locked tax account is used to file a tax return. Between January 2011 and December 31, 2014, the IRS locked approximately 26.3 million taxpayer accounts of deceased individuals. For Filing Season 2015 as of March 5, 2015, the IRS has stopped 10,779 returns with refunds totaling more than \$16.7 million using the account locks. Additionally, the IRS has rejected 460,000 e-filed tax returns through the use of these locks. For the 2013 Filing Season, the IRS also

developed and implemented a clustering filter tool in response to TIGTA's continued identification of large volumes of undetected potentially fraudulent tax returns for which tax refunds had been issued to the same address or deposited into the same bank account. Tax returns identified are withheld from processing until the IRS can verify the taxpayer's identity. For Filing Season 2015 as of January 29, 2015, the IRS reports that, using this tool, it had identified 61,402 tax returns and prevented the issuance of approximately \$196.5 million in fraudulent tax refunds.

However, the IRS still does not have timely access to third-party income and withholding information. Most third-party income and withholding information is not received by the IRS until well after tax return filing begins. For example, the deadline for filing most information returns with the IRS is March 31st, yet taxpayers can begin filing their tax returns as early as mid-January each year. In its Fiscal Year 2015 Revenue Proposal, the IRS once again included a request for a legislative proposal to accelerate the deadline for filing third-party income and withholding information returns and eliminate the extended due date for electronically filed information returns.

Additional information technology investments will likely need to continue. In February 2009, the IRS began developing the new Return Review Program (RRP) to replace its current fraud detection system, the Electronic Fraud Detection System (EFDS), which was implemented in 1994. The IRS determined that inefficiencies and operational challenges render the EFDS too risky to maintain, upgrade, or operate beyond Processing Year 2015. The RRP is intended to be an integrated and unified system. For example, the RRP uses predictive analytics, models, scoring system, and selection groups to identify suspected identity theft tax returns.

Following a successful controlled production launch, the IRS paused further development of the RRP in January 2014. However, the IRS subsequently identified that with a minimal amount of programming it could deliver a simplified identity theft solution using its existing system architecture. Since identity theft is a high priority for the IRS, it decided to proceed with developing the identity theft component of the RRP. On April 16, 2014, the IRS began a pilot of the RRP scoring and models (*i.e.*, filters) to assess its effectiveness in identifying potential identity theft tax returns. Based on the successes from this pilot, the IRS decided to expand the pilot for Filing Season 2015.

EITC Improper Payment Rate

I believe the IRS has studied the EITC improper payment rate. Understanding the sources of the improper rate is critical to figuring how to reduce it.

Question: Could you explain what part of the improper payment rate is attributable to fraud and how much to complexity and confusion?

The IRS does not provide an estimate of the portion of these errors associated with taxpayer error or fraud. However, the IRS has determined that EITC improper payments primarily result from two root causes: authentication and verification. Authentication errors include

errors associated with the IRS's inability to authenticate qualifying child requirements, taxpayers' filing status, and EITC claims associated with complex or nontraditional living situations. Verification errors relate to the IRS's inability to identify individuals who are improperly reporting income to erroneously claim an EITC amount to which they are not entitled. For Fiscal Year 2014, the IRS estimates that 70 percent, or \$12.4 billion, in improper EITC payments resulted from authentication errors and the remaining 30 percent, or \$5.3 billion, resulted from verification errors.

Question: Is there a reason why IRS can't provide this breakdown, as well as a breakdown between paid preparer and self-prepared error rates, at the same time it provides its annual estimate of the improper payment rate?

While the IRS does not report on the portion of the authentication and verification errors associated with taxpayer error or fraud, the Department of the Treasury does report in its annual improper payment reporting the number of fraudulent EITC claims that the IRS identifies and the revenue protected annually. For example, the Department of the Treasury reported in its Fiscal Year 2014 Agency Financial Report (AFR) that through September 2014, using fraud detection filters, the IRS detected and stopped from being processed over 562,000 fraudulent returns, preventing nearly \$1.5 billion in improper EITC payments. The AFR also reports that, as a result of the IRS Criminal Investigation Division investigations, 285 EITC Questionable Refund Program scheme indictments were issued with 262 convictions, as well as 108 EITC Return Preparer indictments with 83 convictions.

In addition, we are not aware of any reason why the IRS can't provide a breakdown between paid preparer and self-prepared error rates. However, the IRS uses the results of examinations of a statistically valid sample of prior year EITC claims conducted as part of the IRS National Research Program to estimate the current Fiscal Year EITC improper payment rate and improper payment dollars. For example, the IRS improper payment estimate for Fiscal Year 2014 is based on examination results for EITC claims filed on Tax Year 2010 tax returns. Using this information may not provide the most precise estimate.

Tax Preparation Assistance

In 2014, the IRS stopped providing free return preparation services at local Taxpayer Assistance Centers. Taxpayers are now directed to use Free File tax preparation software or obtain assistance from Volunteer Income Tax Assistance (VITA) sites or Tax Counseling for the Elderly (TCE) sites. However, the National Taxpayer Advocate reports that VITA and TCE sites are inadequately funded and are unable to meet the influx of demand.

Question: What is the IRS doing to assist taxpayers that are not being captured by VITA or TCE sites due to limited resources?

In June 2014, we reported² that, for the 2014 Filing Season, the IRS eliminated or reduced services at Taxpayer Assistance Centers. One such service was assistance in preparing a tax

² TIGTA, Ref. No. 2010-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 2014).

return. The IRS stated that the intent of its service approach was to balance taxpayer demand for services with the IRS's anticipated budget cuts, redirect taxpayers to online services, enable assistants to dedicate more time to answer tax account-related inquiries, and provide other services at Taxpayer Assistance Centers, such as identity theft services and acceptance of payments.

However, we found that the reduction in service was implemented without completing the required taxpayer burden risk evaluation for the taxpayers most likely to visit a Taxpayer Assistance Center, such as low-income, elderly, and limited-English-proficient taxpayers. The purpose of such an evaluation is to assess the burden that service changes can have on taxpayers. Taxpayers visiting an IRS Taxpayer Assistance Center for assistance in preparing their tax return are notified that this service is no longer provided and are referred to the nearest volunteer site. The IRS referred these individuals without assessing the increase in traffic to volunteer tax return preparation sites to determine which sites would see increases, whether the sites were prepared to handle the additional traffic, and how the increased traffic would affect taxpayer service.

Tax Gap

According to the IRS's budget request, our "tax gap," or the difference between taxes owed and taxes paid, was estimated to be \$385 billion in 2006.

Question: What is the IRS doing to close this gap and by your estimates, how much additional revenue would the IRS be able to collect if the agency is fully funded?

The IRS has developed strategies to reduce the Tax Gap over the course of the past several years. These strategies are multi-faceted and include initiatives that span the entire organization with the ultimate goal of increasing the Voluntary Compliance Rate. The IRS has taken several steps to increase voluntary compliance, including: 1) increasing information reporting activities; 2) implementing new compliance initiatives to assist taxpayers in becoming compliant; and 3) enhancing taxpayer outreach to assist taxpayers in resolving their compliance issues.

TIGTA has found that the IRS is unable to measure actual revenue from its enforcement initiatives included in its annual budget. Although the IRS's primary estimate of Return on Investment (ROI) is based on actual revenue, TIGTA reported in September 2013³ that the IRS continues to be unable to measure actual revenue from individual enforcement initiatives. TIGTA recommended that the IRS perform a feasibility analysis to identify the steps necessary to measure actual revenue for new enforcement initiatives.

Although the IRS is unable to measure actual revenue from its enforcement initiatives, it has expanded the information it reports to stakeholders regarding the ROI achieved by its enforcement efforts. For example, the IRS reported that enforcement revenue was \$57.1 billion in FY 2014, for a total IRS-wide ROI of \$5.1 to \$1. The ROI estimate does not

³ TIGTA, Ref. No. 2013-10-104, *The Use of Return on Investment Information in Managing Tax Enforcement Resources Could be Improved* (Sept. 2013).

include the revenue effect of the indirect deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact.

IRS Service Quality

According to a recent report from the National Taxpayer Advocate, the most serious problem encountered by taxpayers is the declining quality of service provided to them when they try and comply with tax filing and payment obligations. For instance, in 2004, the IRS had a call response rate of 87 percent and hold times averaged two and a half minutes. So far this year, however, response rates have been 43 percent and hold times are averaging almost 30 minutes. I find this very alarming.

Question: I understand that the IRS has asked for increased funding in their budget request and I notice that the agency has been hit especially hard over the past few years. However, could you please expand on IRS efforts to improve taxpayer service, in lieu of increased funding?

In its response to our June 2014 report,⁴ the IRS indicated that, given its budget environment, it must depend even more on technology-based services and external partners. Consequently, the IRS is directing taxpayers to the most cost-effective method to provide the needed service. This allows the IRS to focus limited toll-free and walk-in resources on customer issues that can be best resolved with person-to-person interaction. By using this approach, the IRS believes it is able to improve its ability to serve, address, and resolve more complex matters, such as identity theft victim assistance and tax account issues.

In an effort to continue to redirect taxpayers to online services, the IRS has expanded its online tools available on IRS.gov. For example:

- *Interactive Tax Assistant* - is a tax law resource that takes taxpayers through a series of questions and provides them with responses to basic tax law questions. This tool has been available to taxpayers since January 2008.
- *Where's My Refund* - allows taxpayers to check the status of their refunds using the most up-to-date information available to the IRS. The tool was updated in 2014 so that taxpayers can use a smart phone to check their refund status.
- *Get Transcript* - allows taxpayers to get a transcript of their tax returns. These transcripts are often used to validate income and tax filing status for mortgage applications, student and small business loan applications, and tax preparation.

However, we have identified areas where the IRS could improve its services. For example, we reported that the IRS has not developed a process to expand its Virtual Service Delivery program. The IRS Virtual Service Delivery integrates video and audio technology to allow taxpayers to see and hear an assistor located at a remote Taxpayer Assistance Center, giving the taxpayers "virtual face-to-face interactions" with assistors. Taxpayers can use this

⁴ TIGTA, Ref. No. 2010-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 2014).

technology to obtain many of the services available at Taxpayer Assistance Centers. The goals for Virtual Service Delivery are to enhance the use of IRS resources, optimize staffing, and balance workload.

As of February 2014, the IRS offered Virtual Service Delivery at 30 locations, including 22 Taxpayer Assistance Centers and eight Volunteer Program sites. However, the IRS has not identified underserved areas that would benefit from Virtual Service Delivery. This is despite IRS data that show Virtual Service Delivery is well received by taxpayers and is a cost-effective alternative that could yield improvements in taxpayer service. For example, as of May 2012, 91 percent of taxpayers surveyed would use Virtual Service Delivery terminals again, and 87 percent reported being satisfied with the service they received.

Questions for the Record Submitted by Congressman Sanford D. Bishop, Jr.

Prepared Tax Returns Claiming the EITC

Paid tax preparers file nearly 70 percent of returns that claim the Earned Income Tax Credit (EITC). Until very recently, paid tax preparers have not had to fulfill any IRS competency requirements or even to register as tax preparers with the IRS. I understand the IRS believes that a significant number of EITC errors occur on commercially prepared returns. Unscrupulous preparers may see an opportunity to charge the taxpayer more if they can inflate the refund that the filer receives. In addition, given the EITC's complexity, preparers who are untrained can easily make errors in preparing EITC claims. IRS is now requiring that paid preparers obtain Preparer Tax Identification Numbers in order to file tax returns and is assessing a \$500 penalty for each failure to comply with EITC due diligence requirements.

Question: Do you believe that this initiative will enhance the IRS's ability to hold unscrupulous preparers accountable?

The IRS has reported that its efforts to regulate tax return preparers will drive increased EITC compliance, decrease fraud, and reduce the improper payment rate. While we agree preparer regulation will have some impact on reducing EITC improper payments, it is unknown whether regulation of tax return preparers will result in a significant reduction in the EITC improper payment rate.

On January 18, 2013, a Federal Court enjoined the IRS from enforcing the regulatory requirements for registered tax return preparers. The IRS appealed the Federal Court's decision. On February 11, 2014, the Federal Appeals Court ruled that the IRS does not have the authority to regulate tax preparers by requiring them to pay an annual fee, pass a qualifying exam, and take annual continuing education. The February 2014 Federal Appeals Court ruling means that the IRS can no longer prevent tax return preparers who do not meet minimum proficiency requirements from filing tax returns on behalf of taxpayers, including those claiming the EITC.

Question: Do you think the due diligence requirements are fair and present a low risk of penalizing innocent preparers who rely on the information provided by the taxpayer?

The IRS EITC paid preparer strategy balances enforcement and education of noncompliant tax return preparers. The IRS uses a series of risk factors to identify potentially noncompliant tax return preparers. The IRS then classifies potentially noncompliant preparers by the overall risk factor, the number of EITC claims prepared, and the number of failed EITC compliance filters for tax returns prepared by a preparer. Based on these factors, the IRS will determine the appropriate compliance treatment. For example, tax return preparers with a low risk of noncompliance will receive an educational or compliance letter. Those with a high risk will be considered for more stringent treatment including an examination to determine if the preparer complied with the due diligence rules.

In 2011, the EITC due diligence rules were revised to require preparers to attach Form 8867, *Paid Preparer's Earned Income Credit Checklist*, to each EITC claim they file. Preparers who are not compliant can be assessed a \$500 due diligence penalty for each EITC claim filed for which Form 8867 is not attached. However, the IRS does not assess penalties on all tax return preparers who fail to attach the Form 8867. The IRS only proposes penalties on those preparers who have received prior notification of noncompliance and who filed more than 10 EITC claims. In addition, preparers have 30 calendar days to respond to the penalty letter and request a hearing to appeal the penalty.

Question: What other recommendations do you have for how the IRS can encourage continuing professional education for paid preparers and how the agency can hold them accountable?

The IRS's new voluntary continuing education and certification program can encourage paid preparers to augment their professional education. In April 2014, the IRS announced its commitment to ensuring tax return preparers have a basic competency level and adhere to professional standards by offering the Annual Filing Season Program (AFSP). This program encourages tax return preparers who lack any kind of professional credential or license to complete continuing education courses for the purpose of increasing the participants' knowledge of the law relevant to Federal tax returns, starting with Tax Year 2014 tax returns.⁵ Participants must successfully complete the required 18 hours of continuing education, which must include a six-hour refresher course containing a comprehension test, during the calendar year prior to the year for which the certification is sought.⁶

In addition, beginning in October 2014, the IRS will start issuing a record-of-completion certificate (called an Annual Filing Season Program Record of Completion) to participants who voluntarily complete the required IRS-approved continuing education courses and consent to be subject to the duties and restrictions relating to practice before the IRS. Those tax return preparers who lack any kind of professional credential or license and receive a

⁵ Tax Year refers to the 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with calendar year.

⁶ The continuing education requirement for applicants seeking a record of completion to prepare Tax Year 2014 tax returns was pro-rated to 11 hours.

record of completion certificate will be permitted to represent taxpayers during an examination of a tax return that they prepared.

As an incentive for return preparers to participate in the AFSP, the IRS will launch a public listing, called the Directory of Federal Tax Return Preparers with Credentials and Select Qualifications, on the public IRS web site.

Protecting Against Cyber Attacks

The IRS gathers very sensitive and personal data on millions of taxpayers every year. In the past, TIGTA has identified the security of taxpayer information as one of the top three management challenges facing the IRS. Considering the recent, high-profile computer security incidents such as the Sony hack late last year and the Anthem Health Insurance hack earlier this month, I am concerned about any deficiencies that may make the IRS systems vulnerable to unauthorized access or attack on a broad scale.

Question: Particularly now that the ACA implementation is underway and the State and Federal Exchanges are sharing increasingly more personal taxpayer information with the IRS, what are your priorities regarding the information security measures the IRS has in place to protect against cyber attacks?

The Inspector General has identified Security as the top Management Challenge for the IRS. TIGTA's Office of Audit recognizes the importance of cyber security and has an entire Directorate with three audit groups committed to performing system security audits. In Fiscal Year 2014, TIGTA issued seven security-specific audit reports, including two focused specifically on the protection of taxpayer data. For Fiscal Year 2015, the Office of Audit has included 14 audits in its Annual Audit Plan related to systems security. In addition, TIGTA has reviewed the security plans and security testing of new Affordable Care Act applications in our normal system development reviews.

IRS Hiring Policy

According to your December 2014 report, the IRS hired 323 ex-employees who had previously left the agency due to allegations of misconduct between January 2010 and July 2013. You further asserted that about 20 percent of those rehired after misconduct were involved in new issues at the agency after they returned. This is very concerning considering the agency's already strained resources and the access that employees have to personal taxpayer information.

Question: Do you believe the IRS's hiring process fully took into consideration what these employees did to be removed from the agency in the first place and how would you rate the IRS's hiring process overall?

The employees we sampled with prior performance or conduct issues generally met Office of Personnel Management suitability requirements. However, TIGTA is concerned that the IRS may not be adequately considering prior performance issues when selecting former employees for hire. In addition, we found nothing in the IRS hiring process beyond the

suitability standards where conduct issues were being considered. TIGTA believes the IRS should more fully consider prior conduct and performance issues before making final hiring decisions and we recommended that the IRS work with General Legal Services and the Office of Personnel Management to determine how best to accomplish this.

TIGTA cannot rate the IRS's overall hiring process because our recent audit focused on processes associated with employees hired with prior performance or conduct issues. While we have not conducted an audit of the entire IRS hiring process, TIGTA has made recommendations in recent years to improve specific areas within the IRS's overall hiring process where deficiencies were identified. For example:

- In Fiscal Year 2012,⁷ TIGTA reported that nearly 77 percent of the cases we reviewed did not have sufficient documentation to verify that all required screening steps were completed before the employee reported for duty.
- In Fiscal Year 2013,⁸ TIGTA reported that the IRS had taken action to reduce hiring timelines. However, we also found that data for monitoring the time taken to hire new employees were not always accurate.

Tax Gap

The most recent IRS assessment of the gross Tax Gap was \$450 billion in Tax Year 2006. In a September 2013 report, you expressed concern about the overall accuracy of the estimate and asserted that the estimate could be more comprehensive if it included estimates for the informal economy and offshore tax evasion. Improving the quality and accuracy of tax gap estimates would provide insight to Congress and to the IRS about what is working and what is not working with respect to increasing the voluntary compliance rate. It is my understanding that the IRS agreed with your recommendations to study the feasibility of developing separate estimates for the informal economy and offshore tax evasion.

Question: Can you provide an update on these issues?

The IRS completed its feasibility studies on the informal economy and offshore tax evasion in January 2015. Related to the informal economy, IRS management noted that TIGTA did not provide a clear definition of what constitutes the informal economy and informed us that they believe tax return data are insufficient for distinguishing between formal and informal activities. IRS management also stated that the accuracy of previous attempts to provide this estimate using alternative approaches has been questionable. Given these limitations, the IRS does not believe that allocating a portion of the Tax Gap to the informal economy would provide dependable insights on tax compliance.

With regards to estimating the impact of offshore tax evasion on the Tax Gap, the IRS informed us that the new Foreign Account Tax Compliance Act (FATCA) information documents that became available starting in Tax Year 2014 will assist it in developing these

⁷ TIGTA, Ref. No. 2012-IE-R003, *Inspection of the Employee Pre-Screening Process* (Feb. 2012).

⁸ TIGTA, Ref. No. 2013-10-007, *New Employees Are Being Hired More Quickly: However, Improvements Are Needed To Correct Some Hiring Monitoring Data* (Nov. 2012).

estimates. Although not providing a comprehensive accounting of all offshore income, the IRS indicated the new FATCA information will give it more data on offshore noncompliance. The IRS also indicated that it is currently assessing the adequacy of the designs for both the National Research Project domestic and international samples to ensure sufficient numbers of tax returns with offshore income are available for estimation purposes.

Financial Services and General Government Subcommittee
Hearing on Internal Revenue Service Oversight
Questions for National Taxpayer Advocate
Nina E. Olson

Questions for the Record Submitted by Chairman Ander Crenshaw

Civil Seizures

Earlier this month, the House Ways and Means Subcommittee on Oversight held a hearing about IRS civil seizures as a result of structured payments. Chairman Roskam is deeply concerned that the IRS is using its authority to disrupt and destroy law-abiding, small businesses instead of criminal enterprises. The IRS Commissioner assured him that the IRS is changing its policies to only pursue cases that have a criminal connection.

Question: Was the Taxpayer Advocate Service (TAS) aware of any problems with the IRS civil seizure program? How many seizure cases has TAS worked on recently?

Response: Based on our research described below, no taxpayer came to TAS for relief from a civil forfeiture action. Thus, until recently, TAS was not aware of any problems with the IRS civil seizure program. TAS became aware of the civil seizure and forfeiture issue through the press. TAS has followed Congressional activity in this area, including proposed legislation. TAS staff recently met with representatives from the IRS Criminal Investigation (CI) Division and the IRS Office of Chief Counsel (Criminal Tax) to discuss the IRS's changes in civil asset seizure and forfeiture policy and accompanying revisions to the Internal Revenue Manual (IRM). This new policy provides that the IRS-CI will not pursue the seizure and forfeiture of funds solely associated with "legal source" structuring cases unless there are exceptional circumstances justifying the seizure and forfeiture and the case has been approved at the Director of Field Operations level.

TAS searched its case database and was unable to locate any TAS cases involving civil asset seizure or forfeiture issues. This may be because attorneys representing taxpayers in these cases usually are not tax attorneys who are familiar with TAS services. However, TAS will monitor this issue and follow up to determine whether the IRS's new policy is being carried out in practice. Depending on the facts and circumstances of a particular case, TAS may also be able to assist taxpayers who experience problems with the IRS's administration of civil asset seizures and forfeitures.

IRS Overseas Offices

The IRS is closing all their overseas Taxpayer Assistance Center this year, but is asking for \$8 million to open Criminal Investigation offices next year in South Africa and Dubai.

Question: Does it make sense for the IRS to only have an Enforcement presence overseas and no Taxpayer Service presence?

Response: I am deeply concerned about the IRS's plans to close all IRS overseas offices that offer in-person taxpayer service, especially because it has identified no viable alternative for these taxpayers. As I have discussed in my Annual Reports to Congress in recent years, the IRS decreased the number of tax attaché posts in foreign cities from 15 to four, while increasing the number of locations and employees devoted to criminal investigations.¹ Despite the growth of the international taxpayer base, the IRS has announced its plans to eliminate all tax attaché posts, citing the multi-year decrease in funding.² At the same time, the IRS maintains 10 Special Agent attachés in Bogota, Colombia; Mexico City, Mexico; London, England; Frankfurt, Germany; Ottawa, Canada; Hong Kong, China; Bridgetown, Barbados; Beijing, China; Panama City, Panama; and Sydney, Australia.³

I am very concerned about the IRS's shift of emphasis away from providing basic in-person taxpayer service, including outreach and education, especially given the overwhelming complexity of the international tax rules and reporting requirements and the potentially devastating penalties for even inadvertent noncompliance.⁴ The IRS's one-sided approach to international tax administration, focused on stepped-up enforcement without basic in-person service, may lead some voluntarily compliant taxpayers to give up and become

¹ National Taxpayer Advocate 2011 Annual Report to Congress 156, fn. 39. See also National Taxpayer Advocate 2009 Annual Report to Congress 134-154. Since the 1980s, the IRS has steadily reduced its civil tax presence overseas to save on security, construction, and maintenance costs.

² On November 30, 2014, the IRS closed its Beijing office. Memorandum from Acting Deputy Commissioner, International (LB&I), to IRS executives, Re: Beijing Post Closure, (Oct. 16, 2014). The IRS will close tax attaché offices in Frankfurt, Germany, London, UK, and Paris, France, on June 26, 2015, Sept. 19, 2015, and Dec. 26, 2015, respectively. Memorandum from Acting Deputy Commissioner, International (LB&I), Re: Post Closures of Frankfurt, London and Paris (Feb. 18, 2015).

³ Data from IRS, Criminal Investigations, International Operations.

⁴ Since 2009 the IRS has also suspended overseas assistance tours at U.S. embassies because these tours were not cost-effective and "minimal in relation to the number of taxpayers living abroad." During the last overseas assistance tour from February 28 to March 31, 2008, IRS employees provided face-to-face assistance to 2,603 individuals at 21 U.S. embassies, spending approximately four days at each location. In 2007, Wage and Investment (W&I) division employees assisted 2,090 individuals at 25 locations. W&I responses to TAS research request (Oct. 14, 2009, Oct. 19, 2009).

noncompliant, and ultimately increase the international tax gap. The inability of taxpayers to access IRS services from abroad combined with the increased threat of criminal prosecution may contribute to growing confusion and frustration about U.S. tax administration. Further, it may undermine taxpayer rights *to be informed, to quality service, and to a fair and just tax system* as described in the Taxpayer Bill of Rights (TBOR) adopted by the IRS.⁵

I have recommended that the IRS explore the use of voice-over-Internet-protocol (VOIP) and other alternative methods of telephone service that will allow the IRS to contact taxpayers, and taxpayers to contact the IRS, without paying international call rates. I have also recommended that the IRS open more foreign tax attaché offices, place a Local Taxpayer Advocate at each one, and collaborate with the Department of State to train embassy and consulate staff to provide a full range of taxpayer services, including assistance with preparation of tax returns, similar to what the Social Security Administration does for beneficiaries overseas.⁶ I have discussed this issue in detail in my Annual Reports to Congress. For a recent discussion, see the section titled *International Taxpayer Service: The IRS Is Taking Important Steps to Improve International Taxpayer Service Initiatives, but Sustained Effort Will Be Required to Maintain Recent Gains* in my 2013 Annual Report.⁷

Question: Do you think these actions are signs of the IRS abandoning its mission to provide taxpayers with top quality service?

Response: Yes. I am concerned that the IRS's emphasis on criminal investigations in the international tax arena while eliminating basic in-person taxpayer assistance may significantly undermine its mission and strategic goal to "deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance." This enforcement-oriented approach to international tax administration also runs contrary to the IRS's objectives to "deliver clear and focused outreach, communications and education programs to assist taxpayer understanding of tax responsibilities and emerging tax laws," and to "provide timely assistance through a seamless, multichannel service environment to encourage taxpayers to meet their tax obligations and accurately resolve their issues."⁸

As I stated in my testimony, the elimination of overseas posts could not come at a worse time, as taxpayers abroad are facing unique challenges in complying

⁵ IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

⁶ See National Taxpayer Advocate 2013 Annual Report to Congress 213; National Taxpayer Advocate 2011 Annual Report to Congress 165.

⁷ National Taxpayer Advocate 2013 Annual Report to Congress 205-213. See also National Taxpayer Advocate 2011 Annual Report to Congress 129-172 (contains six most serious problems facing international taxpayers in understanding and meeting their federal tax obligations).

⁸ IRS, Strategic Plan 2014-2017.

with their obligations under the Foreign Account Tax Compliance Act (FATCA),⁹ Foreign Bank and Financial Accounts (FBAR) reporting rules,¹⁰ and the Affordable Care Act (ACA).¹¹ The combination of increased requirements and less support means that over 7.6 million U.S. taxpayers living abroad,¹² over 300,000 U.S. military personnel and their families,¹³ and hundreds of thousands of students and foreign taxpayers with U.S. tax obligations,¹⁴ all of whom benefitted from the Taxpayer Assistance Centers overseas, must either obtain all their information from IRS.gov web pages or call the IRS toll line in the United States. If they choose the latter option, they have only about a 50 percent chance of reaching a live assistor, may wait on hold for 30 minutes or more, and must pay country-to-country long-distance charges for the call.¹⁵

In my testimony, I recommended that Congress require the IRS to retain and provide funding for its four tax attaché offices abroad, and provide funding for and require the IRS to establish Local Taxpayer Advocates in each of those cities.

Preventing Fraud

During the hearing, you testified that some countries and states do not pay tax refunds until a month or two after the tax filing deadline. This gives them time to

⁹ FATCA was passed as a part of the Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat 71 (2010) (adding Internal Revenue Code (IRC) §§ 1471-1474 & 6038D).

¹⁰ See 31 U.S.C. §§ 5314, 5321; 31 C.F.R. §§ 1010.350, 1010.306(c); FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), http://www.fincen.gov/forms/bsa_forms.

¹¹ The Patient Protection and Affordable Care Act of 2010 (ACA), Pub. L. 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, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

¹² The Department of State estimates that 7.6 million U.S. citizens live abroad and more than 70 million U.S. citizens travel abroad annually. U.S. Department of State, Bureau of Consular Affairs (May 2014), <http://travel.state.gov/content/dam/travel/CA%20Fact%20Sheet%202014.pdf> (last visited on Jan. 19, 2015). The number of U.S. citizens overseas increased by more than 50 percent in just five years. National Taxpayer Advocate 2013 Annual Report to Congress 205-213.

¹³ U.S. Department of Defense, *Active Duty Military Personnel, Strength by Regional Area and by Country* (Mar. 31, 2011).

¹⁴ National Taxpayer Advocate 2011 Annual Report to Congress 129-272. Since 2011, the National Taxpayer Advocate has recommended establishing international LTA offices at the IRS's four tax attaché offices abroad. See also National Taxpayer Advocate 2013 Annual Report to Congress 213; National Taxpayer Advocate 2009 Annual Report to Congress 183.

¹⁵ The Commissioner of Internal Revenue estimated that only about 50 percent of taxpayers who call would be able to reach the IRS after waiting "30 minutes or more for limited service over the phone." Commissioner Koskinen, *Fiscal Year 2015 Funding* (Dec. 17, 2014). See also IRS, *Contact My Local Office Internationally*, <http://www.irs.gov/uac/Contact-My-Local-Office-Internationally>; National Taxpayer Advocate 2013 Annual Report to Congress 205-213.

authenticate and verify the information reported on the return before paying out refunds, which prevents a lot of fraud.

Question: Please identify a few of these countries and States.

Answer: Sweden is an example of a country that receives third-party data before its filing season begins, and makes that information available to its taxpayers for use in preparing and reviewing their tax returns. The data becomes available in early April, and taxpayers can file their returns without penalty by early May (this year, May 4, 2015). The Swedish Tax Agency states that if taxpayers file electronically by that date, it will pay out electronic refunds in June.¹⁶ The combination of early receipt of third-party information and delayed refund release enables the agency to check the accuracy of returns.

More generally, several countries receive third-party information reports before the beginning of or early in the filing season and provide their taxpayers with a pre-filled return option, thereby ensuring greater accuracy on returns and only paying out refunds after receiving third-party information reporting. The following countries have all implemented some form of early receipt of third-party reporting and pre-filled returns: Australia, Chile, Denmark, Estonia, Finland, France, Hong Kong, Iceland, Italy, Lithuania, Malta, New Zealand, Norway, Portugal, Singapore, South Africa, Spain, Sweden, and Turkey.

I have not recommended that the IRS develop pre-filled or pre-populated returns. Rather, to maintain market competition, I have recommended that the IRS provide taxpayers with the option of downloading third-party data into Free Fillable Forms, Free File, or commercial software (both off-the-shelf or that used by tax professionals). A fully populated return for most taxpayers is not feasible in the United States given the complexity of the Internal Revenue Code and the extent of information that is necessary for filing and is not derived from third-party information reports (e.g., household members, principal residence of child, etc.).¹⁷

Also note that the high incidence of fraud during the 2015 filing season has prompted many state tax administrations to delay issuing refunds. Thus, when faced with significant fraud, the initial response is to hold refunds until additional safeguards are in place.¹⁸ Arguably, the strongest anti-fraud step a tax administration can take is to delay paying refund claims until it has the opportunity to match the return against third-party data.

¹⁶ See Swedish Tax Agency, at <http://www.skatteverket.se/service/ankar/otherlanguages/inenglish/individualemployees/aboutthetaxreturn/taxrefundinjune.4.71004e4c133e23bf6db800054968.html>.

¹⁷ National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 77.

¹⁸ Jonnelle Marte, *FBI is Investigating Fraudulent Tax Returns Filed through TurboTax*, WASH. POST, Feb. 11, 2015.

Question: Did these countries and States historically pay refunds after the filing period or did they make a transition from paying refunds during the filing period?

Response: We do not have this information available.

Question: What are some pros and cons to paying refunds after the filing period?

In this country, the IRS processes tax returns and pays out refunds two or three months before they have much information about you. To prevent a resource intensive pay-and-chase game, the Administration is asking to accelerate the day that employers submit W-2's to the IRS.

Response: My 2013 annual report included a research study in which we recommended that the IRS delay the issuance of refunds.¹⁹ The benefits of such a delay include:

- **Reduction in Improper Payments and Other Errors.** Given the opportunity to match information reports to tax returns prior to issuing refunds, the IRS will be able to identify more improper claims for credits and deductions before releasing the funds. This approach will not only improve administration of refundable credits and enable the IRS to match third-party information reports to tax return entries, but also allow the IRS to identify “whipsaw” issues prior to paying out refunds, e.g., where the same child is claimed on different returns, or misreporting of alimony payments.
- **Reduction in Identity Theft.** If the IRS has the opportunity to match information reports before issuing refunds, it may be able to reduce the incidence of tax-related identity theft.

The drawbacks of delaying refunds include:²⁰

- **Potential Detrimental Impact on Low Income Taxpayers.** Due to the substantial amount of the average tax refund, many taxpayers rely on their income tax refunds to pay down debt or pay bills. In fact, many low income taxpayers use these refunds, including their refundable credits, to pay their winter utility bills.
- **Impact Cost of Tax-Related Loans.** For commercial refund products with loan components, the length of the loan term increases when the refund is delayed. For example, refund anticipation checks (RACs) include a loan

¹⁹ National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 93-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*).

²⁰ For more details, see National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 93-96.

for the tax preparation fee. If the term of this loan component of the product increases, the product will involve more risk to the financial institution offering the RAC, which will likely translate into higher fees charged to the taxpayers. In addition, the more data matching the IRS performs upfront, the greater the risk that it will not pay out the entire anticipated refund. This greater risk imposed on the providers will make them less profitable and may drive some out of the market.

- Government Accused of Profiting off the Float. If the IRS delays refunds, some will complain that the government will profit off the “float” – *i.e.*, earn more interest while holding onto the funds longer. However, corresponding later deadlines for tax payments may counter that argument. Further, with proper planning, taxpayers could minimize this concern by adjusting their withholdings and reducing the size of their refunds.

Question: Would the IRS achieve the same results from processing the returns later in the year as it would from requiring W-2’s to be sent earlier?

Response: The above-discussed 2013 research study also includes a recommendation to tighten information reporting deadlines.²¹ This is the most straightforward way to enable the IRS to receive third-party information earlier and, as a result, provides the IRS more time to perform matching before issuing refunds. However, this option is not without risks. For example, the earlier the filing deadline, the higher the incidence of corrections to information reports. The 2013 study recommends that the IRS create a *de minimis* dollar threshold for corrections to reduce the need for amended returns.²²

I should note that the complexity of Form W-2 makes early filing difficult, particularly in the area of valuation of benefits. Furthermore, Forms W-2 are first submitted to the Social Security Administration (SSA) to allow the SSA to “scrub” the data before transmitting it to the IRS. The 2013 research study proposed a pilot to determine whether the IRS can screen Form W-2 data as effectively as the SSA. If it can, both the IRS and SSA should receive the reports at the same time (or the IRS could receive the information directly and forward it to the SSA).²³

Given the potential burden imposed on third-party payors and preparers of information reports, any initiative to accomplish earlier reporting deadlines should include extensive discussions with the industry. When determining any potential revision in filing deadlines, it would also be helpful to work closely with foreign,

²¹ National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86.

²² *Id.* at 88.

²³ *Id.* at 85-86.

state, and local tax administrations that have experience with tightened information reporting deadlines.²⁴

Premium Tax Credits – Reconciliation

The 2015 filing season is the first one that requires the IRS to reconcile taxpayers' actual 2014 income with the estimate of their 2014 income used to apply for the advance premium tax credits in 2013.

Projecting income isn't easy to do, especially if you work hourly or on commission. You never really know how many hours you'll get, if overtime or extra shifts become available, or when the next big sale occurs. Bonuses and raises are also hard to predict.

Question: Even though we're only mid-way through the filing season, has your office received any cases from individuals who are accustomed to receiving a tax refund, but are now facing a tax liability because of the assumptions used to calculate their advance premium tax credit?

Many individuals do not realize they must report the cancellation of debt (in some cases) and conversion of funds from a traditional IRA to a Roth IRA as income.

Response: TAS has completed an initial review of all 96 of the cases we have received this filing season relating to the Premium Tax Credit.²⁵ We have identified two cases in which the taxpayers ended up owing money due to their Advanced Premium Tax Credit received in 2014. TAS will continue its case review and include the results in the National Taxpayer Advocate's FY 2016 Objectives Report to Congress (which will be released around June 30, 2015).

Question: Has your office received cases from individuals who were unaware of how taxable events in one aspect of their lives resulted in ineligibility for or a reduction in the premium tax credit?

Response: TAS has completed an initial review of all 96 of the cases we have received this filing season relating to the Premium Tax Credit. We have identified one case in which the taxpayer was unaware of how taxable events in one aspect of his life resulted in ineligibility for, or a reduction in, the Premium Tax Credit. We have identified 17 cases in which the taxpayer's income increased while the tax refund decreased, but we have not yet determined whether that is due to APTC received during 2014.

²⁴ For examples of states and countries that have tighter information reporting deadlines, see National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-88.

²⁵ TAS's review included 138 ACA cases received through February 26, 2015. Ninety-six of those cases were related to the Premium Tax Credit. In those 96 cases, taxpayer returns were delayed in the Error Resolution unit or were otherwise placed in a hold status pending further IRS review.

Questions for the Record Submitted by Congressman Mark Amodei

Cost Efficiency

Congress appropriated \$206 million to the Taxpayer Advocate Service (TAS) in the FY 2015 Consolidated Appropriations Act. Nina Olson testified that while she did not know the exact mean income level, the typical individual served by TAS in any given tax year is middle to low-income.

Question: What percentage of revenue does TAS capture for the IRS in their services to help taxpayers prepare their returns?

Response: See below.

Question: What percentage of revenue does the income demographic the TAS typically serves bring in to the IRS yearly?

Response: See below.

Question: What is the income demographic of those typically served by TAS?

Response: The above three cost efficiency questions relate to the demographic segments of the taxpayer population that TAS serves and the revenue the IRS collects from these segments. Since TAS serves a broad variety of taxpayers, it would be difficult to characterize these taxpayers in terms of a single demographic. Our response below therefore attempts to address all three questions by providing an overview of the taxpayers we serve both with respect to income and taxes paid.²⁶

Individual Taxpayers

Overall, we were able to find the underlying income tax return for about 85 percent of taxpayers seeking TAS assistance in 2014.²⁷ As detailed below, determining individual taxpayer income is much easier than finding the income tax circumstances of business taxpayers. However, some individual taxpayers will not have a filing requirement and therefore have no corresponding tax return.

Over 90 percent of taxpayers seeking TAS assistance in 2014 were individual taxpayers. About 90 percent of these taxpayers filed an income tax return (Form 1040 series) for tax year 2013. The following table depicts the average (mean),

²⁶ Our analyses were conducted on the Compliance Data Warehouse, which contains a broad variety of IRS production data and is available to the IRS Research community to conduct studies and ad hoc analyses.

²⁷ Specifically, we analyzed cases newly received by TAS in calendar year 2014.

median, and decile²⁸ values for reported total tax paid and adjusted gross income:

Tax Year 2013 Individual Tax Return Data for Taxpayers Initiating New TAS Cases in 2014

Statistic		Total Tax	Adj. Gross Inc.
Number of Taxpayers		181,531	181,531
Mean		\$ 24,253	\$ 82,076
Median		\$ 718	\$ 23,600
Percentiles	10	\$ -	\$ 5,962
	20	\$ -	\$ 10,591
	30	\$ -	\$ 14,129
	40	\$ 21	\$ 17,788
	50	\$ 718	\$ 23,600
	60	\$ 1,580	\$ 32,159
	70	\$ 2,806	\$ 46,197
	80	\$ 6,198	\$ 70,336
	90	\$ 15,462	\$ 119,420

Although the tax year 2013 median tax reported by taxpayers TAS served in 2014 was only \$718, the average tax paid was over \$24,000. For the population of all individual income tax filers in tax year 2013, the median tax paid was over twice as high at over \$1,700; however, the average tax paid was only slightly over \$9,000. Accordingly, individual taxpayers coming to TAS in 2014 only accounted for slightly over one tenth of one percent of the number of returns filed by individuals in tax year 2013, but over a third of one percent of the total tax dollars paid by individuals.

Similarly, the median tax year 2013 adjusted gross income of taxpayers seeking TAS assistance in 2014 was less than \$24,000, but the average reported adjusted gross income for these taxpayers was over \$82,000. In contrast, the population of tax year 2013 individual filers had a median reported adjusted gross income of nearly \$34,000, but an average adjusted gross income of less than \$62,000. Therefore, although the typical TAS taxpayer is low to middle income, TAS also provides assistance to taxpayers with higher reported adjusted gross incomes and total tax paid.

²⁸ A decile is any of nine values that divide the data into ten equal parts, so that each part represents 1/10 of the sample or population. For example, 20 percent of the individual tax returns in the table had an adjusted gross income below \$10,591.

Business Taxpayers

Business taxpayers comprised less than 10 percent of the taxpayer entities that sought TAS assistance in 2014. Where possible, we determined the tax and income information for Form 1120 (general corporations), Form 1120S (Sub S Corporations), and Form 1065 (partnerships) filers. However, we could only find the business entity income for about 43 percent of businesses who sought TAS assistance.

There are several reasons for this limitation. First, we only looked for tax year 2013 business tax returns and some businesses we assisted probably ceased operations prior to 2013. Second, many of the businesses were probably sole proprietorships. TAS would have their employer identification numbers (EIN) because they came to TAS seeking our help with employment-tax-related issues. These taxpayers, however, do not file business income tax returns, but instead file Forms 1040 to report their incomes and compute their tax liabilities. Accordingly, we could not include these taxpayers in our analysis because we only have their EINs, not their SSNs. On the other hand, if a sole proprietor came to TAS for assistance with an income tax issue, it would be listed under the SSN and included in the individual taxpayer data discussed above. Of the individual taxpayers who came to TAS for assistance in 2014, 25.9 percent had sole proprietorship income.

Third, we could only capture tax information for taxpayers who filed Form 1120. They reported mean taxes paid of \$696,960. Corporations that file Form 1120S and partnerships report income but do not report taxes paid. Instead, the income flows through to forms 1040 and is taxed as individual income. Therefore, the following table depicts only the decile values reported for ordinary income earned by the business entity.

Tax Year 2013 Ordinary Income for Business Entities TAS Served in 2014

Statistic		Ordinary Income
Number of Taxpayers		7,505
Mean		\$ 3,747,544
Median		\$ 20,406
Percentiles	10	\$ (44,689)
	20	\$ (5,655)
	30	\$ -
	40	\$ 6,285
	50	\$ 20,406
	60	\$ 41,634
	70	\$ 79,018
	80	\$ 169,558
	90	\$ 528,414

Question: As a percentage of pay-out, how much has the TAS been responsible for returning to tax-payers?

Response: Individual taxpayers coming to TAS for assistance in 2014 received nearly \$147 million in manual refunds.²⁹ However, nearly 80 percent of taxpayers received income tax refunds. Therefore, the amount of manual refunds attributable to taxpayers seeking TAS assistance in 2014 is less than one-half of one percent of the total refunds the IRS issued during 2014.³⁰ We cannot determine what portion of the refunds these taxpayers received was attributable solely to TAS assistance.

²⁹ These taxpayers received manual refunds, which are often prepared by TAS. However, while we are certain the taxpayers received manual refunds, some refunds could have been generated by other IRS employees.

³⁰ Individual Returns Transaction File for tax year 2013, Individual Master File for calendar year 2014, Taxpayer Advocate Management Information System.

Questions for the Record Submitted by Congressman Mike Quigley

Same Sex Marriage Filing

After DOMA was struck down by the Supreme Court in 2013, married same-sex couples had the ability to file federal taxes together for the first time during the last filing period.

Question: Following this incredibly significant change in federal law, are you aware of any significant implementation issues and, if so, what do you think the IRS must do to address these issues?

Response: I remain concerned that the IRS's automatic sorting criteria and its identity theft and revenue protection filters may inadvertently flag certain returns of same-sex individuals, thus imposing an unnecessary burden on these taxpayers. However, I am unaware of any significant implementation issues.

I have recommended that the IRS review and issue formal and informal guidance regarding its implementation of identity theft and revenue protection filters in light of common filing scenarios facing same-sex spouses to ensure that the IRS does not freeze or delay their legitimate refund claims. I have discussed this problem at length in my Annual Reports to Congress. For a recent discussion, see the section titled *TAS Continues to Monitor the IRS's Implementation of the Supreme Court Decision in Windsor and Processing of Same-Sex Marriage Returns and Related Claims* in my Fiscal Year 2015 Objectives Report to Congress.³¹

Question: What has the IRS done to educate taxpayers about this change and what resources have you provided, or plan to provide, for same-sex marriage filers during this transition?

Response: The main service channel the IRS has used to educate same-sex couples and certain domestic partners about these changes has been the IRS.gov website. The IRS initially posted a news release, IR-2013-72, *Treasury and IRS Announce That All Legal Same-Sex Marriages Will Be Recognized for Federal Tax Purposes; Ruling Provides Certainty, Benefits and Protections under Federal Tax Law for Same-Sex Married Couples*, with a subsequent revenue ruling, notices, FAQs, and a video.³²

³¹ For further information on same-sex spouse issues, see National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 129-133 (Area of Focus: *TAS Continues to Monitor the IRS's Implementation of the Supreme Court Decision in Windsor and Processing of Same-Sex Marriage Returns and Related claim*). See also National Taxpayer Advocate 2013 Annual Report to Congress 256-263 (Most Serious Problem: *DEFENSE OF MARRIAGE ACT: IRS, Domestic Partners and Same Sex Couples Needed Additional Guidance*).

³² See IRS, IR-2013-72, *Treasury and IRS Announce That All Legal Same-Sex Marriages Will Be Recognized For Federal Tax Purposes; Ruling Provides Certainty, Benefits and Protections Under Federal Tax Law for Same-Sex Married Couples* (Aug. 29, 2013), available at <http://www.irs.gov/uac/Newsroom/Treasury-and-IRS-Announce-That-All-Legal-Same-Sex->

During this transition, TAS has reviewed all draft Internal Revenue Manuals and other IRS guidance to identify potential same-sex marriage issues, developed training regarding the legal history of same-sex marriages and related advocacy opportunities, and advocated successfully for the IRS to add a new program code for amended returns moving from separate to married filing joint filing status to identify potential processing problems with DOMA returns.

I will continue to focus on these issues and assist taxpayers in resolving their issues relating to DOMA, monitor the impact of the *Windsor* decision on case inventories, and identify related trends in our case inventory using the new special case code "DM" that flags cases in which the account issues are a direct result of the reversal of DOMA and Revenue Ruling 2013-17. I have also recommended that the IRS continue updating the "Frequently Asked Questions" section of IRS.gov to address taxpayer questions about same-sex married couples (who are treated as married for federal purposes) and registered domestic partners (who are not), and issues affecting both, such as community property and estate and gift taxes. I have discussed this problem at length in my Annual Reports to Congress. For a recent discussion, see the section titled *TAS Continues to Monitor the IRS's Implementation of the Supreme Court Decision in Windsor and Processing of Same-Sex Marriage Returns and Related claims in my Fiscal Year 2015 Objectives Report to Congress*.³³

Marriages-Will-Be-Recognized-For-Federal-Tax-Purposes%3B-Ruling-Provides-Certainty,-Benefits-and-Protections-Under-Federal-Tax-Law-for-Same-Sex-Married-Couples (last visited on Mar. 11, 2015); Rev. Rul. 2013-17, 2013-38 IRB 201; Notice 2013-61, 2013-44 IRB 432, Notice 2014-19, 2014-17 IRB 979; and Notice 2014-37, 2014-24 IRB 1100. The IRS has also released additional information including IRS, Frequently Asked Questions for same-sex Couples, available at <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples> (last visited Mar. 11, 2015); IRS, Answers to Frequently Asked Questions for Registered Domestic Partners and Individuals in Civil Unions, available at <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Registered-Domestic-Partners-and-Individuals-in-Civil-Unions> (last visited Mar. 11, 2015); IRS, Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married Under State Law, available at <http://www.irs.gov/uac/Answers-to-Frequently-Asked-Questions-for-Same-Sex-Married-Couples> (last visited Mar. 11, 2015); IRS, New IRS Video Helps Same-Sex Couples; Joins Extensive IRS Library Of Online Tax Tips available at <http://www.irs.gov/uac/Newsroom/New-IRS-Video-Helps-Same-Sex-Couples> (last visited Mar. 11, 2015); IRS, Treatment of Marriages of Same-Sex Couples for Retirement Plan Purposes available at <http://www.irs.gov/Retirement-Plans/Treatment-of-Marriages-of-Same-Sex-Couples-for-Retirement-Plan-Purposes> (last visited Mar. 11, 2015); and IRS, Application of the Windsor Decision and Post-Windsor Published Guidance to Qualified Retirement Plans FAQs available at <http://www.irs.gov/Retirement-Plans/Application-of-the-Windsor-Decision-and-Post-Windsor-Published-Guidance-to-Qualified-Retirement-Plans-FAQs> (last visited Mar. 11, 2015).

³³ For further information on same-sex spouse issues, see National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 129-133 (Area of Focus: *TAS Continues to Monitor the IRS's Implementation of the Supreme Court Decision in Windsor and Processing of Same-Sex Marriage Returns and Related claim*).

Identity Fraud

I was shocked to read in a recent GAO report that the IRS is estimated to have paid out \$5.8 billion in fraudulent refunds last year. That's an increase of over 60 percent since 2011.

Question: What would you attribute to this increase?

Response: I do not believe there is a clear-cut answer to this question. My sense is that the increase in tax refund fraud is simply the result of criminals seizing the opportunities before them. Anecdotally, we have heard of gangs that have given up drug trafficking to engage in the much easier, safer, and equally lucrative endeavor of tax refund fraud. The potential benefits seem to far outweigh the potential risks, despite the IRS Criminal Investigation Division's and the Department of Justice's increased focus on prosecuting individuals charged with fraudulent tax refund schemes. I suspect that the increase in refund fraud is primarily a result of criminals choosing the path of least resistance.

Question: What is the IRS doing to adapt to the evolving challenges of identity theft and in your opinion, do you think we can get in front of this issue without additional investments in IT?

Response: Additional investments in IT would help the agency perform many of its core operations, but I believe there are other steps Congress and the IRS can take to make progress on this issue.

The most important step is to fundamentally change our approach to return processing so the IRS can match tax return data against third-party information reports before issuing refunds. Currently, the IRS cannot routinely verify reported earnings and withholding amounts before issuing refunds. It issues most refunds within 21 days, and many in seven to ten days or less, so refunds are often paid in late January or February – long before the IRS receives Form W-2 data from most employers. As a consequence, identity thieves who have obtained valid name/SSN combinations on the black market can file returns using falsified wage and withholding information, and the IRS has a limited ability to identify these false claims. If the employers were required to submit W-2s earlier in the year and the IRS delayed the payment of refunds until it received and processed this W-2 information, refund fraud would be substantially curtailed.

Another potential solution is to require a second form of authentication when filing a tax return. Today, as noted above, anyone can, with minimal effort, obtain all of the information required to file a return purporting to be from another person. SSNs are bought, borrowed, and stolen like commodities. The IRS issues Identity Protection PINs (IP PINs) to some victims of identity theft, and it started a pilot program in several states where taxpayers without known identity-theft problems could ask for an IP PIN. Once this unique six-digit number is

assigned, the taxpayer must provide it in conjunction with the SSN (or other Taxpayer Identification Number) in order for the IRS to process the return.

The IRS could expand the use of IP PINs to anyone who wants one (regardless of whether the taxpayer has been victimized by ID theft) or develop a similar authentication approach. It would require more effort on the part of both taxpayers and the IRS, but I think this is an option that should be seriously considered. Criminals who steal SSNs with the intention of filing falsified tax returns would largely be thwarted.

EITC Improper Payment Rate

I believe the IRS has studied the EITC improper payment rate. Understanding the sources of the improper rate is critical to figuring how to reduce it.

Question: Could you explain what part of the improper payment rate is attributable to fraud and how much to complexity and confusion?

Response: The IRS has not explained what part of the improper payment rate and measurement is attributable to fraud versus complexity and confusion. As I reported in my 2011 Annual Report to Congress, it is important to possess the underlying data and assumptions when the IRS reports the EITC improper payment rate.³⁴ The Office of Management and Budget recently requested that the Department of the Treasury “provide a comprehensive action plan” which would include, among other things, a description of the “root causes” of improper payment rates.³⁵

However, some research regarding EITC errors is available. TAS research showed that some of the EITC improper payment rate likely results from complexity and taxpayer confusion.³⁶ I have also drawn attention to the role that unenrolled tax return preparers play in EITC compliance.³⁷ Data from the IRS’s

³⁴ National Taxpayer Advocate 2011 Annual Report to Congress 306 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance Measures and Take Steps to Improve Both Service and Compliance*). In particular, I recommended that the IRS update the estimate of EITC improper payments, disclose the methodology utilized, and share the data and methodology with TAS and the general public. *Id.* at 306.

³⁵ Letter from Shaun Donovan, Director, Office of Management and Budget, to Jacob J. Lew, Secretary of the Treasury 1 (Feb. 26, 2015).

³⁶ See National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 27 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*); see also National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 108 (*IRS Earned Income Tax Credit Audits – a Challenge to Taxpayers*).

³⁷ See *Internal Revenue Service Oversight, Hearing Before the H. Subcomm. on Financial Services and General Government Committee on Appropriations*, 113th Cong. (2014) (statement of Nina E. Olson, National Taxpayer Advocate), available at <http://docs.house.gov/meetings/API/AP23/20140226/101771/HHRG-113-AP23-Wstate-OlsonN-20140226.pdf>.

National Research Program (NRP) show that taxpayers who claim the EITC are more likely than non-claimants to rely on paid preparers.³⁸ EITC claimants are also more likely to rely on unenrolled preparers,³⁹ who have the highest frequency and percentage of overclaims.⁴⁰

Question: Is there a reason why IRS can't provide this breakdown, as well as a breakdown between paid preparer and self-prepared error rates, at the same time it provides its annual estimate of the improper payment rate?

Response: I agree with the implication of the question that more data would be helpful. However, my understanding is that the IRS does not attempt to distinguish between fraud and complexity or confusion, because this analysis would require the examiner to interpret the intentions of the taxpayer. This is not something included in National Research Program (NRP) audits and therefore is not information the IRS currently can supply.

Data from the NRP do show the percentage of overclaims varies depending on whether the taxpayer or a paid preparer prepares the return. When the return is self-prepared, the dollar overclaim percentage is between 39 percent and 28 percent.⁴¹ This is higher than the percentage for most paid preparers. For instance:

- CPAs have a dollar overclaim percentage between 31 percent and 27 percent,⁴²
- National tax return preparation firms have a dollar overclaim percentage of between 30 percent and 20 percent,⁴³ and
- Unenrolled return preparers who are not affiliated with a national firm have the highest dollar overclaim percentage, measuring between 40 percent and 33 percent.⁴⁴

³⁸ Only 29 percent of EITC claimants self-prepare their tax returns compared to 43 percent of non-claimants who prepare their own returns. IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 24 (Aug. 2014).

³⁹ Forty-three percent of EITC claimants relied on an unenrolled preparer, while 28 percent on non-claimants relied on unenrolled preparers. *Id.*

⁴⁰ *Id.*

⁴¹ IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 26 (Aug. 2014).

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

Tax Preparation Assistance

In 2014, the IRS stopped providing free return preparation services at local Taxpayer Assistance Centers. Taxpayers are now directed to use Free File tax preparation software or obtain assistance from Volunteer Income Tax Assistance (VITA) sites or Tax Counseling for the Elderly (TCE) sites. However, the National Taxpayer Advocate reports that VITA and TCE sites are inadequately funded and are unable to meet the influx of demand.

Question: What is the IRS doing to assist taxpayers that are not being captured by VITA or TCE sites due to limited resources?

Response: I have expressed significant concerns about the IRS's decision to stop all tax preparation services at Taxpayer Assistance Centers (TACs) and to refer taxpayers to the Volunteer Income Assistance or Tax Counseling for the Elderly sites for tax preparation assistance. I am unaware of any IRS plans to assist taxpayers who do not qualify for VITA or TCE assistance. The halt to return preparation at TACs leaves these taxpayers with very limited options. They can use Free File Fillable Forms or Free File software that is free for qualified taxpayers if they feel comfortable preparing their own returns online. Otherwise, they will have to hire a tax preparer or buy commercial software.⁴⁵

I have recommended that the IRS provide tax preparation assistance at TACs in areas with limited access to VITA or TCE volunteers, along with proper staffing and hours to handle taxpayer traffic. I have discussed this problem at length in my Annual Reports to Congress. For a recent discussion, see the section titled *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure is Not Adequately Based on Specific Needs of Serviced Taxpayer Populations* in my 2014 report.⁴⁵

Tax Gap

According to the IRS's budget request, our "tax gap," or the difference between taxes owed and taxes paid, was estimated to be \$385 billion in 2006.

Question: What is the IRS doing to close this gap and by your estimates, how much additional revenue would the IRS be able to collect if the agency is fully funded?

⁴⁵ See IRS, *Free File: Do Your Federal Taxes for Free*, <http://www.irs.gov/uac/Free-File--Do-Your-Federal-Taxes-for-Free>.

⁴⁶ For further information on VITA and TCE service issues, see National Taxpayer Advocate 2014 Annual Report to Congress 55-66 (Most Serious Problem: *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure is Not Adequately Based on Specific Needs of Serviced Taxpayer Populations*).

Response: The actual return on investment depends on how the dollars are allocated. Former IRS Commissioner Doug Shulman estimated the return on investment for each additional dollar given to the IRS is about six to one.⁴⁷ The current commissioner, John Koskinen, estimated the return on investment for each additional dollar given to the IRS at about 4.8 to one.⁴⁸ (For all appropriated dollars the IRS received in FY 2014, the return on investment was about 271:1. That is, the IRS collected about \$3.064 trillion on an appropriated budget of about \$11.29 billion.)

The current period of IRS budget freezes and reductions began in FY 2010. If IRS funding were restored to the FY 2010 level and adjusted for inflation, the IRS would receive about \$2.35 billion more. Applying the return on investment estimated by Commissioners Shulman and Koskinen would yield approximately \$11 to \$14 billion in additional revenue. I caution, however, that I do not know how the IRS arrived at these return-on-investment ratios.

IRS Service Quality

According to a recent report from the National Taxpayer Advocate, the most serious problem encountered by taxpayers is the declining quality of service provided to them when they try and comply with tax filing and payment obligations. For instance, in 2004, the IRS had a call response rate of 87 percent and hold times averaged two and a half minutes. So far this year, however, response rates have been 43 percent and hold times are averaging almost 30 minutes. I find this very alarming.

Question: I understand that the IRS has asked for increased funding in their budget request and I notice that the agency has been hit especially hard over the past few years. However, could you please expand on IRS efforts to improve taxpayer service, in lieu of increased funding?

Response: Since FY 2008, the IRS has annually documented the major taxpayer service improvement initiatives it has implemented in annual reports to Congress. These reports for fiscal years 2008 through 2012 are available here:

<http://www.irs.gov/Individuals/Taxpayer-Assistance-Blueprint--1>

⁴⁷ Written Testimony of Douglas H. Shulman, Commissioner of Internal Revenue, Before the Subcomm. on Oversight of the H. Comm. on Ways & Means, on the 2011 Filing Season and FY 2012 Budget Request, March 31, 2011.

⁴⁸ Written Testimony of John A. Koskinen, Commissioner of Internal Revenue, Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations, on the FY 2015 IRS Budget Request, April 30, 2014.

The report documenting implemented FY 2013 taxpayer service improvement initiatives is available here (the report for FY 2014 is still under development):

www.irs.gov/pub/irs-pdf/p4701.pdf

In general, as reflected in the FY 2013 report (above), the emphasis has been on enhancement of existing web-based resources and development of new web-based tools and information sources. IRS research shows, however, that taxpayers are more likely to rely on personal service for complicated tasks such as notices and payment information, and that low income, elderly and limited English proficiency taxpayers are more likely to rely on the TACs and phones than other taxpayers.⁴⁹

As reported in the National Taxpayer Advocate's testimony, in response to budget cuts and growing workload, IRS delivery of personal services has declined to very low levels in the current (2015) filing season:

- From January 1 through March 21, the IRS answered only 38 percent of the calls it received from taxpayers seeking to speak with a customer service representative on its Account Management telephone lines.⁵⁰ (This compares with 72 percent for the same period in 2014.)
- For taxpayers who managed to get through, the average wait time was about 25 minutes.⁵¹
- The IRS is answering far fewer tax-law questions than it used to. During the filing season, it is not answering any questions except "basic" ones. After the filing season, it will not answer any tax-law questions at all, leaving the roughly 15 million taxpayers who file later in the year unable to get any answers to their questions by calling or visiting IRS offices.⁵²
- The IRS has eliminated return preparation.⁵³

⁴⁹ See IRS, *Progress on the Implementation of the Taxpayer Assistance Blueprint: Five-Year Progress Report: FY 2008 - FY 2012 5-8* (February 12, 2013); see also IRS, *The Taxpayer Assistance Blueprint: Taxpayer Service Improvements: October 2012 to September 2013*, 2-3 (March 24, 2014).

⁵⁰ IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending March 21, 2015).

⁵¹ *Id.*

⁵² IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>. These restrictions were implemented in 2014.

⁵³ *Id.*

- The IRS has reduced its training funds by 83 percent since FY 2010, leaving employees less equipped to do their jobs properly.⁵⁴
- In the key Accounts Management individual taxpayer correspondence and amended return/duplicate filing correspondence programs, nearly 55 percent of the inventories were overage as of March 21, 2015 (*i.e.*, have not been handled within established timeframes).⁵⁵

The IRS can only restore these services to acceptable levels with additional personnel to answer the phones, staff the TACs, and respond to taxpayer correspondence.

⁵⁴ IRS Chief Financial Officer, Corporate Budget.

⁵⁵ IRS, Customer Account Services Accounts Management Paper Inventory Reports, *Inventory Age Report – All Programs* (week ending March 21, 2015).

**Questions for the Record Submitted by Congressman Sanford D. Bishop,
Jr.**

Low Income Taxpayer Clinic Program

Your testimony to Congress about providing representation and services to low income taxpayers a couple years before you were appointed National Taxpayer Advocate was very significant in the creation of the Low Income Taxpayer Clinic (LITC) program. By providing matching grants of up to \$100,000 per year to organizations that operate low income taxpayer clinics, the LITC program ensures that resources are available to many low income individuals, including veterans and those who are elderly, disabled, victims of domestic violence, or speak English as a second language. In 2014, the IRS awarded nearly \$10 million in grants to 133 grantees located in 47 states and the District of Columbia.⁵⁶ However, many Southern states, where there are disproportionate numbers of low income individuals, have only one federally funded LITC.

Question: How can the Taxpayer Advocate Service (TAS) more effectively disseminate grant information to gather more applications from underserved regions, particularly in rural areas?

Response: TAS formally disseminates information about LITC matching grants and the application process for obtaining a grant by annually issuing IRS Publication 3319, *LITC Grant Application Package and Guidelines*, which is available to the public at www.irs.gov. Information about LITC grant funding opportunities and the annual application period is also published in:

- The Federal Register, the official journal of the federal government of the United States that contains government agency rules, proposed rules, and public notices (www.federalregister.gov);
- The Catalogue of Federal Domestic Assistance (CFDA), a government-wide compendium of Federal programs, projects, services, and activities that provide assistance or benefits to the American public (www.cfda.gov); and
- Grants.Gov, a web-based system that provides a centralized location for federal agencies to post discretionary funding opportunities and for grant seekers to find and apply for federal funding opportunities (www.grants.gov).

⁵⁶ The IRS publishes Publication 4134, *Low Income Taxpayer Clinic List*, on an annual basis. It identifies the organizations receiving a grant that year and contains contact information and details regarding the types of services each clinic provides. Two clinics withdrew from the program, reducing the total number to 131.

In Publication 3319, TAS identifies particular underserved areas and encourages grant applications from organizations seeking to create, develop, or expand a clinic to serve taxpayers who reside in these areas. Publication 3319 for grant year 2016, which TAS anticipates issuing in May 2015, will identify the following states and territories as underserved: Alabama, Alaska, California, Colorado, Georgia, Mississippi, North Carolina, North Dakota, Oklahoma, South Carolina, Texas, Utah, and Puerto Rico.

TAS also uses the LITC Program Office and Local Taxpayer Advocates to publicize information about the LITC program and the availability of grant funding. The LITC Program Office annually issues IRS Publication 5066, *LITC Program Report*, which describes the program's activities and the representation, education, and advocacy work performed by grantees on behalf of low income taxpayers and those who speak English as a second language. The LITC Program Office sends a copy of Publication 5066 and a letter to academic institutions and legal services providers in underserved areas, encouraging these organizations to establish clinics and apply for matching grants. Local Taxpayer Advocates conduct outreach to community-based organizations and institutions, as well as local Congressional offices, which provides an additional opportunity to identify and encourage applicants for LITC funding.

Question: While there certainly is a need for an LITC in many more parts of the country, how can TAS better prioritize population need as well geographic need in administering grant awards?

Response: The National Taxpayer Advocate's 2014 Annual Report to Congress includes a TAS Research study, *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*. This study was developed with the goal of learning more about taxpayers who are eligible for help from LITCs. A phone survey of more than 1,100 individuals gathered information on eligible taxpayers' awareness and use of LITC services, the types of issues for which they would consider using clinics, demographic information, and other subjects.

Among the study's key findings:

- LITC Awareness: About half of all LITC-eligible taxpayers hired a tax preparer to complete their federal tax return.
- LITC Awareness: About 30 percent of all eligible taxpayers were aware of an organization outside the IRS that helps taxpayers with IRS problems. Among the aware, only about ten percent knew the name of the organization is "Low Income Taxpayer Clinic."
- LITC Use: About two out of three LITC eligible taxpayers stated they were likely or very likely to use an LITC if they had a need for its services.

- **LITC Interactions:** Participants indicated they were willing to travel 20-30 minutes to a clinic. In-person meetings and meetings at a community services center were preferred by over 75 percent of all eligible taxpayers. Only about ten percent were willing to interact by computer or videoconference.
- **Language:** More than 90 percent of all respondents stated they prefer to discuss their taxes in English, compared to about 20 percent of Spanish speakers. Over 75 percent of Spanish speakers said they prefer speaking Spanish during tax discussions.
- **Education:** A majority of all LITC-eligible taxpayers have some college education. There are differences in this measure by total vs. Spanish speaking, with Spanish speakers having considerably lower education levels.

The LITC study findings and other studies show that technology adoption and use are not the same across incomes, education levels, age groups, and several other demographic measures. The National Taxpayer Advocate remains concerned that the IRS will make decisions about service that will leave this vulnerable population behind. As the IRS moves away from traditional in-person services such as live telephone assistance or face-to-face interactions at walk-in offices, some groups of taxpayers will be impacted more than others. These types of service reductions increase the value of and the critical need for LITC services among low income taxpayers. TAS has shared this information with the LITCs and will use it in reviewing the clinics' program plans to ensure they address the most significant needs of the LITC population.

Taxpayers Who Speak English as a Second Language

Most taxpayers and even many tax professionals would agree that the tax code is complex and confusing enough in English.

Question: While the Taxpayer Advocate Service provides services to individuals who speak English as a second language, what programs or mechanisms does the IRS have in place to assist taxpayers who speak English as a second language and how effective are those programs?

Response: The IRS provides multiple services in Spanish for taxpayers, but could do still more to assist these taxpayers and increase voluntary compliance. The IRS has a Spanish-language website for the public on "the Español Web Site" at <http://www.irs.gov/Spanish>.⁵⁷ In my 2008 Annual Report to Congress, I recommended that the IRS translate the complete content of IRS.gov into Spanish, followed by expansion of IRS forms and publications into other

⁵⁷ IRM 22.31.1.10 (Nov. 6, 2012).

languages.⁵⁸ The IRS disagreed with this recommendation despite TAS's offering our assistance and experience in developing these and other multilingual products and services as part of the federal government's effort to expand and integrate products and services for Limited English Proficient (LEP) taxpayers.⁵⁹

The IRS makes certain documents available in languages other than English. Documents the IRS has designated as vital for translation, which include those containing critical information for accessing tax services, rights, and/or benefits or those required by law, are translated into Spanish by the Multilingual & Agency Services (MAS) Branch of the IRS Wage and Investment Division if there is no alternate means of obtaining the information.⁶⁰ In 2011, I recommended the IRS make relevant web resources, forms, and publications, including publication 519, *U.S. Tax Guide for Aliens*, available in major foreign languages.⁶¹ I also recommended that the IRS develop focused outreach and separate publications in foreign languages for special groups of nonresident alien taxpayers and foreign entities. TAS has worked with the IRS to make progress on both of these recommendations.

According to the IRS's Telephone Transfer Guide, calls are transferred to one of 49 English lines or 29 Spanish lines.⁶² The IRS provides Spanish oral language assistance from bilingual assistants, when available. If not available, the IRS may use an over-the-phone interpreter (OPI).⁶³

In addition, TAS employs more than 70 bilingual case advocates who can work directly with taxpayers with limited English proficiency without the need for an interpreter. TAS has a Bilingual Case Advocate Study Team that analyzes and recommends improvements to the use and efficiency of bilingual resources. In addition, TAS has translated into Spanish ten letters that it commonly sends to taxpayers while working their cases. TAS has also created and distributed a bilingual handout about the Taxpayer Bill of Rights.

The Low Income Taxpayer Clinic Program, administered by TAS, provides many services to Spanish-speaking taxpayers. Clinics provide free or low-cost

⁵⁸ See National Taxpayer Advocate 2008 Annual Report to Congress 157.

⁵⁹ See Executive Order 13166, *Improving Services for Persons with Limited English Proficiency* (LEP), 65 Fed. Reg. 50121 (2000); see also Policy Statement P-22-3, IRM 22.31.1.1.2 (Apr. 1, 2006). *E.g.*, TAS employees have participated significantly in the production of the Basic Tax Responsibility DVD in Russian in partnership with the recently established Multilingual Initiative Program.

⁶⁰ See IRM 22.31.1.6.1 (Nov. 6, 2012). Department of Justice LEP Guidance. 67 Fed. Reg. 41455, and Department of Treasury LEP Guidance. 70 Fed. Reg. 6067, require translation for the regularly encountered LEP language groups of documents considered vital. IRM 22.31.1.2.3 (Nov. 6, 2012).

⁶¹ See National Taxpayer Advocate 2011 Annual Report to Congress 150.

⁶² See IRS Telephone Transfer Guide (updated Jan. 21, 2015).

⁶³ See IRM 22.31.1.6.1 (Nov. 6, 2012).

representation for low income taxpayers in disputes with the IRS, education about tax rights and responsibilities for taxpayers who speak English as a second language (ESL), and advocacy about tax issues that affect these taxpayers.

Organizations applying for LITC matching grants must identify the ESL population(s) for which the clinic will provide representation, education, and outreach; identify the methods and media that the LITC will use to reach ESL taxpayers; and list the languages served in addition to English. Applicants must also provide demographic information for the geographic area that the clinic will serve, including the number of low income and ESL residents. Grantees must report:

- The number of ESL taxpayers represented in controversies with the IRS;
- The number of consultations conducted with ESL taxpayers;
- The number of education activities conducted for ESL taxpayers and the number of ESL taxpayers who attended; and
- The languages in which educational activities were conducted;

Question: What measures does the IRS have in place to protect taxpayers with limited English proficiency from becoming victims of identity theft, tax scams, and impersonation?

Response: The IRS provides some information in other languages to make taxpayers aware of the risks of identity theft. For example, IRS.gov users can toggle between English and several other languages. In addition, the IRS published its annual list of the “dirty dozen” top tax scams for the 2015 filing season in Spanish, available at <http://www.irs.gov/Spanish/Phishing-Permanece-en-la-Lista-del-IRS-de-la-Docena-Sucia-del-2015>.

This notice also includes a link to a Spanish language video warning of phishing schemes at <https://www.youtube.com/watch?v=T44r241qGjE>.

The Identity Protection page on IRS.gov lists tips for how taxpayers can avoid being victimized by identity theft, and what to do if they have been victimized. This page is available in both English and Spanish at <http://www.irs.gov/Spanish/El-IRS-trabajará-con-victimas-del-robo-de-identidad>.

LITCs play a valuable role in assisting taxpayers, many of whom speak English as a second language, in a variety of tax disputes with the IRS, including identity theft and return preparer fraud cases. In addition, LITCs educate low income and ESL taxpayers about their rights and responsibilities as U.S. taxpayers. Educational efforts provide taxpayers with information that helps protect them from identity theft, tax scams, unscrupulous tax preparers, and predatory offer-in-compromise mills. Educational topics include, among other matters, return filing obligations, tax recordkeeping, choosing a reputable tax preparer, avoiding refund anticipation loans, identity theft protection, and the IRS collection process.

Identify Theft and Preparer Fraud

Georgia is number two for identity theft cases and Preparer Fraud. 44% of the cases received in 2014 from Georgia were ID theft-related cases. The IRS has not passed any guidance regarding Preparer Fraud cases. Victims face financial and economic hardship as a result of the Preparer absconding with their refunds and leaving the Taxpayer with an IRS balance due, in addition to not ever receiving the refund the IRS rightfully owes them. For example, a Georgia taxpayer was in the process of purchasing a home when a preparer diverted her refund to the preparer. The taxpayers lost the home, her down payment placed on the home, and her car. The taxpayer stated that the Preparer is getting ready to open a new tax preparation business, giving her plenty of opportunities to steal refunds from additional unsuspecting victims. As the IRS reduces tax preparation services, taxpayers are forced to seek preparation services for a fee, leaving them at risk of obtaining services from unscrupulous tax preparers.

Question: What recommendations do you have for a resolution for this problem?

Response: Many taxpayers, especially low income taxpayers, feel overwhelmed by the tax compliance burden and seek the assistance of tax return preparers. The IRS, to its credit, recognized the benefit of ensuring that paid tax return preparers can meet minimum competency standards, but a U.S. Court of Appeals concluded that the IRS lacks the authority to enforce competency standards absent explicit congressional authorization.

I have recommended that Congress provide that authorization to protect taxpayers from incompetent preparers and to improve tax compliance, particularly in the EITC area. Until mandatory preparer standards are instituted, I believe some type of voluntary certification program offered by the IRS would allow legitimate preparers to differentiate themselves from the unscrupulous, opportunistic, and predatory individuals who offer to prepare tax returns as a pretense to steal refunds from unsuspecting victims. With a certification program in place, taxpayers may think twice about having a used car dealership or a neighborhood acquaintance prepare their tax returns. The IRS should mount an outreach program that communicates the importance of using certified practitioners and warns the public about the potentially significant risks of not doing so.

TAS has created a poster to warn taxpayers that if they pay for return preparation, the preparer is required to give them a copy of the return and sign it with his or her name, company name, and address.

Earned Income Tax Credit

The Earned Income Tax Credit has been a tremendous source of relief for low- and moderate-income working families by decreasing poverty and increasing work. However, its complexity is a significant cause of its high error rate.

Section 32(k) of the Internal Revenue Code authorizes the IRS to ban taxpayers from claiming the Earned Income Tax Credit for two years if the IRS determines they claimed the credit improperly due to reckless or intentional disregard of rules and regulations. Many low-income taxpayers do not fully understand the rules and regulations for claiming the credit and may inadvertently claim the credit without knowing that they are ineligible. IRS procedures often do not take this into account and the IRS may apply the two-year ban on the basis of unexamined or presupposed assumptions about the taxpayer's state of mind.

Question: Do you have any recommendations for how the IRS can revise these procedures to require inquiry into actual reckless or intentional disregard of the rules by the taxpayers, while also avoiding the risk of overpayments?

Response: The IRS should recognize that the issue of eligibility for EITC is separate from the question of whether an admittedly ineligible taxpayer claimed EITC recklessly or with intentional disregard of rules and regulations. As I pointed out in my 2013 Annual Report to Congress, the IRS can best ascertain the taxpayer's state of mind by speaking with him or her.⁶⁴ In the same conversation, the IRS can better educate a taxpayer about the requirements for claiming EITC, which may reduce the risk of future overpayments. Specifically, the IRS should:

- Attempt to speak with a taxpayer before imposing the two-year ban;
- Explain the reason for the disallowance of the EITC in the current year and any prior years; and
- Discuss eligibility for the credit in future years.

Moreover, the IRS should treat the EITC audit as an opportunity to educate taxpayers about the requirements for EITC eligibility. Specifically, as part of an EITC audit, IRS correspondence should explain why a taxpayer's substantiating documentation was insufficient. The explanation should address why the EITC is being disallowed even though the substantiation:

- Affords proof or evidence of the EITC claim;
- Shows a sincere effort to prove the elements of EITC; or
- Shows that the taxpayer believed he or she was qualified to claim the EITC.

Finally, the IRS should conduct a 100 percent quality review of all cases where the two-year ban is imposed to ensure that its employees fully document the basis for determining the taxpayer is intentionally or recklessly disregarding the rules or regulations, and that a manager has approved the ban, as required by the Internal Revenue Manual. TAS's 2013 study of actual two-year ban cases

⁶⁴ National Taxpayer Advocate 2013 Annual Report to Congress 103-115 (Most Serious Problem: *EARNED INCOME TAX CREDIT: The IRS Inappropriately Bans Many Taxpayers from Claiming EITC*).

showed the IRS failed to meet these requirements in an overwhelming number of cases.

Math Error Authority

Math error authority, an effective processing tool when used appropriately, enables the IRS to adjust the tax return to reflect the correct tax liability without referring the case to Examination for a resource-intensive audit of the return, thereby freeing up Examination resources to pursue other forms of noncompliance. However, expansion of math error authority into more complex or fact-intensive areas undermines IRS efficiency by increasing the risk of inaccurate assessments and creating more work down the road for the IRS.

Question: If the IRS were able to resolve some math error discrepancies through internal research, relieving some of the burden on taxpayers by preventing unnecessary math error notices from being sent out, would this extra work on the front end eliminate an equal or greater amount of work and resources expended overall?

Response: In my testimony, I reported on a research study TAS conducted several years ago that reviewed IRS accuracy with respect to math error adjustments relating to dependents claimed on Forms 1040.⁶⁵ For tax year 2009, nearly 300,000 returns contained errors with dependent taxpayer identification numbers (TINs). During math error processing, the IRS disallowed over \$200 million of credits claimed on these returns, but it subsequently reversed at least part of its dependent TIN math errors on 55 percent of them. Ultimately, about 150,000 taxpayers had their refunds restored. On average, the IRS allowed nearly \$2,000 per return after the initial disallowance, with a delay of nearly three months.⁶⁶ Furthermore, analysis of a sample of taxpayers who did not contest these assessments showed that about 40,000 taxpayers were denied refunds they were probably entitled to receive.

In this example, the IRS not only imposed significant burden and caused anxiety for these taxpayers, but it created significant rework for itself. TAS research identified about 55 percent of the abated math errors that could have been resolved if the IRS had used internally available data. While it is not possible to quantify precisely how much rework was required, I believe resolving the discrepancies through internal research upfront would have reduced the overall expenditure of IRS resources. A modest investment of time to research IRS

⁶⁵ See National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 116-20 (*Math Errors Committed on Individual Tax Returns – A Review of Math Errors Issued on Claimed Dependents*).

⁶⁶ The total restored to taxpayers was about \$292 million. This amount exceeds the amount of credits initially disallowed, because it includes both restored credits and related tax reductions (e.g., taxpayers received the benefit of exemptions that were initially disallowed when the credits were disallowed).

databases prior to issuing math error assessments would have eliminated the need to send out about 28 percent of the math error notices, the related phone calls and correspondence from taxpayers, and the employee time spent abating the assessments and processing later refunds.

WEDNESDAY, MARCH 18, 2015.

INTERNAL REVENUE SERVICE—BUDGET

WITNESS

HON. JOHN A. KOSKINEN, COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. CRENSHAW. Good morning, everyone. The meeting will come to order.

I want to welcome the Internal Revenue Service Commissioner John Koskinen to our committee here today to discuss the 2016 IRS budget request.

This is a busy time for the IRS. And so, Mr. Commissioner, we appreciate you being here today to share your testimony and answer any questions we might have.

Now, for 2016, the IRS is requesting a massive \$2 billion or 18-percent increase. Commissioner, last month, you told the Senate Finance Committee that the IRS was not asking for a budget increase but just for the money that was taken away from you, presumably, by this committee. And it came as a surprise to me to learn that you might believe the IRS is entitled to \$13 billion because entitlements are for programs like Social Security and Medicaid.

National security, it is a Constitutional duty, but even the Department of Defense has to appear before the Appropriations Committee. They have to justify their budget request. They have to subject themselves to the Congressional oversight before Congress provides DOD with any funds.

And so IRS has to do the same.

Now, contrary to what we all read in the media from time to time about this Committee, we are not here to simply punish the IRS. We are here to hold the IRS accountable for the use of the taxpayer dollars. We deliberately—yes, we deliberately lowered the IRS funding to a level that would make the IRS think twice about what you are doing and why you are doing it because you don't have a single dime to spare on anything frivolous or foolhardy or even mediocre.

Now, the IRS should focus on its core mission of providing taxpayer services such as processing returns and issuing refunds, providing customer service like answering the telephone, and catching tax cheats. If the IRS wants more solid and sustainable funding, then the IRS needs to show Congress and the American taxpayers that it can manage its funding responsibly and administer the Tax Code in an objective way.

But, unfortunately, it seems like we read week after week after week about one form of IRS mismanagement or another, such as overlooking 50,000 tax returns filed using incorrect information;

hiring former employees with known conduct problems; paying bonuses to tax-delinquent employees; frequent and costly executive travel; lacks oversight of purchase cards; lavish spending on conferences; and last but not least, applying extra scrutiny to certain tax-exempt organizations.

And then, to add insult to injury, the budget request seeks to eliminate some of the key provisions that we on this committee added to help the IRS move past this series of mismanagement. A provision that says you cannot target, well, that is not in the request. A provision that requires videos to be reviewed for appropriateness, that is gone. A provision that requires compliance with the Federal Records Act, that is gone. A provision that guards against excessive conference spending, that is not in the request. There is a provision that we put in to uphold the confidentiality of tax returns, that is gone.

Now, to me, these are just commonsense good government reforms that we put in the bill to help restore the trust in the IRS. So I hope that when you submit your 2017 budget that you might think about adding them back to your budget request.

Now, we talk about doing more with less around here. These are tough economic times. And, Commissioner, I have heard your complaints about doing less with less—it is hard to do less with more. But I want to remind you that additional dollars are not the only solution. In fact, last month, the Government Accountability Office, or the so-called GAO, a nonpartisan agency, said, quote, “Although resources are constrained, IRS has flexibility in how it allocates resources to ensure that limited resources are utilized as effectively as possible, magnifying the importance of strategically managing operations to make tough choices about what services to continue providing and which services to cut,” end quote.

So, instead of asking for the money that has been taken away from you, what I would hope that you would do is to study your budget line by line, prioritize your activities, and reengineer your business processes to deliver these priorities. This is your opportunity to show this committee and to show all Americans that it is no longer business as usual with the IRS. This is an opportunity to show that you have shaken things up and turned things around. We hope you will do that.

And, finally, I just want to highlight some landmark legislation that was enacted last year, called the Achieving a Better Life Experience Act, or the so-called ABLE Act. The ABLE Act opens the door to a brighter future for millions of Americans with disabilities, allows them to set up a tax-free savings account similar to a 529 to save for college.

Now, States are responsible for administering this program and some of the States have already started the legislative process to create these ABLE accounts, but the IRS is required to issue regulations by June 19. So I fully expect the IRS is going to meet that statutory guideline.

So, again, let me thank you, Mr. Commissioner, for being here today.

Let me turn to my distinguished ranking member, Mr. Serrano, for any comments he might have.

Mr. SERRANO. Thank you, Mr. Chairman.

And I join you for welcoming the Commissioner back before the subcommittee.

We are here today at a very serious time for the Internal Revenue Service. Last year, the IRS budget was cut by \$346 million, leaving the Agency at the lowest level of funding since fiscal year 2008. Since fiscal year 2010, the IRS has been cut by more than \$1.2 billion. And if some in the other party had their way, it would have been cut even further.

The results of these cuts are predictable. Is it a surprise to anyone that the IRS telephone response rates have plummeted? Is it news to anyone that the IRS is unlikely to collect as many taxes when we reduce their funding in such a ham-handed way? This subcommittee has a constant debate about the impact of additional dollars in the IRS budget. But today we debate the converse: What is the impact of less dollars to the IRS and to this Nation?

We are already finding out. In this fiscal year, the cut of \$346 million is expected to result in a \$2 billion reduction in taxes collected. The math is simple: For every dollar this subcommittee cuts from the IRS last year, the country lost almost \$6 in tax revenue that is owed to it. These are not numbers that can simply be made up by efficiencies, no matter how hard people may try. That is not a sustainable course. As the responsibilities of the IRS grow, we simply cannot keep pretending the IRS can do more with less. The numbers already tell us that they cannot.

And this brings me to the IRS fiscal year 2016 budget request. Your budget requests significant investments in the agencies to reverse the cuts sustained by the agency over the last few years. Your proposal plans to invest in much needed efforts to assist taxpayers to fight against identity theft, to implement the Affordable Care Act and the Foreign Account Tax Compliance and to go after offshore tax cheats.

From your proposed enforcement efforts alone, you expect to collect an additional \$3.47 billion by fiscal year 2018. It is our job on the Appropriations Committee to vet the budget request of the administration. And that is what we will do here today. But it is also our job to make sure that agencies have their resources to run effectively. And, with regard to the IRS, we have failed in that responsibility. Moreover, the cuts to the IRS don't just impact the agency or even the American taxpayer; they impact our deficit.

No one here can claim the mantle of fiscal responsibility if they plan to support excessive and harmful cuts to the very agency that brings in more than 90 percent of our revenue. It is time to stop punishing the IRS and time to start reinvesting in the one part of the Federal Government that most Americans have an interaction with.

Commissioner, welcome back, and I look forward to your testimony.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

I now would like to recognize the Chairman of the full committee, Mr. Hal Rogers, for any opening statement he might make.

Chairman ROGERS. Mr. Chairman, thank you very much for your courtesy in yielding me time.

Mr. Commissioner, we are glad to see you here. I am not sure you feel mutually the same way. But it is always good to see someone with strong Kentucky roots in the hearing room, particularly during basketball season, and particularly—

Mr. KOSKINEN. It looks like a good year for you.

Chairman ROGERS. Yeah, it looks like it, but we will see.

While I think much of you personally, Mr. Commissioner, I unfortunately find many aspects of the budget request troublesome. Since fiscal year 2011, this Committee has pared back IRS' astronomical budget requests on a bipartisan basis. This is largely a result of this committee's concerted effort to reduce discretionary spending government-wide; justifiable concern over the implementation of Obamacare and the Foreign Account Tax Compliance Act; and various objectionable management decisions at the agency—for example, targeting certain groups and holding lavish conferences at taxpayers' expense. It is therefore surprising to see that the fiscal year 2016 budget request that you have for the IRS is \$12.9 billion, a significant 18-percent increase over the current level. The majority of this proposed increase, \$2 billion, would be utilized to implement Obamacare and the Foreign Account Tax Compliance Act, and towards a discretionary cap adjustment.

There are a number of issues with this request, but three in particular stand out. First, the Budget Control Act does not allow for a discretionary cap adjustment for the IRS. As you know, that would require a statutory change outside the jurisdiction of this committee—a legislative change that has been rejected by both the House and Senate Budget Committees for 4 consecutive years. If the activities funded by the discretionary cap adjustment are important to this administration, then you ought to operate within the amount allowed under the Budget Control Act. The IRS needs to prioritize its spending like every other federal agency.

Second, this Congress has repeatedly rejected additional funding for the implementation of Obamacare. I am concerned, as are many of my colleagues, that the IRS, through CMS, recently made \$2.7 billion in payments to insurance companies without the approval of Congress. The courts will be the ultimate arbiter of this issue, but I can say without a doubt that this committee has never appropriated a single penny to permit the administration to make any Section 1402 Offset Program payments.

Speaking of the courts, I would be remiss if I did not acknowledge *King v. Burwell*, currently under consideration by the Supreme Court, which will determine whether the IRS can extend taxpayer subsidies to individuals who purchase coverage through the healthcare exchange developed by the Federal Government. While the Supreme Court probably won't rule on the case until this summer, now is a good time to start thinking about the potential impact of the case on the IRS.

Finally, I am disappointed that the IRS requests to eliminate the three administrative provisions that have been enacted on a bipartisan basis for several years. Since the IRS' targeting and spending scandals, Appropriations bills have included prohibitions against: targeting U.S. citizens for exercising their First Amendment rights, targeting groups for regulatory scrutiny based on their ideological beliefs, and making videos without advanced approval. We are

dealing with taxpayers' money, and these provisions lay out what most people would consider common-sense policies.

Finally, Mr. Commissioner, I want to mention, in the last couple of days, we have seen press reports that there are literally billions of dollars annually that are being paid fraudulently to people who don't deserve or earn them under the law, a good chunk of that in the IRS. I mean, this is an open sieve. It seems to me, that people who do not qualify for assistance are gaining lots of money for doing nothing except lying and your agency is responsible for cleaning up most of that. It is not all in the IRS, but a big chunk is. And so I would hope that we would hear from you today about how you want to tackle that huge problem that is ongoing.

Mr. Commissioner, I thank you for being with us today. This committee takes seriously our role in overseeing the budget and policies of the IRS and the other Federal agencies, and I appreciate your continued engagement with us. Thank you.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you, Mr. Chairman.

And now I would like to recognize the Commissioner for an opening statement. If you could keep that in the neighborhood of 5 minutes, it will give us more time for questions and answers. The floor is yours.

Mr. KOSKINEN. Thank you. Chairman Crenshaw, Chairman Rogers, Ranking Member Serrano, members of the subcommittee, thank you for the opportunity to discuss the IRS budget and current operations.

I remain deeply concerned that the significant reductions in our budget over the past 5 years are undermining the agency's ability to continue to deliver on its mission. As you all know, IRS funding has been reduced \$1.2 billion over the last 5 years. At the same time, the number of taxpayers has increased over 7 million and the IRS has been given significant additional responsibilities. These include the statutory mandates that we implement, the Foreign Account Tax Compliance Act, or FATCA, and the Affordable Care Act.

The disconnect between our funding levels and our increased responsibilities is illustrated to some effect by the fact that 3 days after our budget was cut by \$350 million, Congress passed legislation requiring the IRS to design and implement two new programs by July 1. Implementation of the ABLE Act, mentioned by the Chairman, and the certification requirement for professional employer organizations is occurring while we are in the middle of our most complicated filing season in years. But I would assure the Chairman, we will continue to do our best to implement these two new programs.

In discussing our need for adequate funding, I understand we have an obligation to be careful stewards of the taxpayer dollars we receive, and we must be as efficient as possible. The IRS has, in fact, made considerable efforts for several years to find efficiencies in our operations, both in regard to personnel and in nonlabor spending. Through cuts in office space, contracts, printing, and mailing, we are saving over \$200 million a year. We have also made significant progress over the past few years in moving millions of taxpayer inquiries from our call centers and walk-in sites to our significantly updated and improved Web site.

Already this filing season, there have been more than 215 million visits to IRS.gov and more than 3.6 million visits to the section devoted to the Affordable Care Act. We have had over 164 million hits on our “Where’s My Refund” electronic tracking tool, and more than 11 million copies of previously filed tax information has been obtained online with our “Get Transcript” application. In the past, all of these inquiries would have inundated our phone lines and resulted in even longer lines at our walk-in sites. But the efficiencies we have created, even in the limited-funding times we have had, have made significant improvements for taxpayers.

I would also emphasize that we take seriously issues raised about the inappropriate actions and activities in the past. We have done that by making necessary changes and improvements in our policies and procedures to ensure these situations do not recur. We have cut conference spending by over 80 percent. We have established review boards for video productions and training expenses. We have ensured that those who willfully failed to meet their tax obligations are not eligible for performance awards as well as being subject to other discipline.

We are reviewing our hiring process to ensure, to the extent permissible by law, that former employees with prior conduct issues are not rehired. We now require that all contractors maintain the same high standard for tax compliance as employees. And we have implemented the recommendations of the Inspector General with regard to the serious management failures surrounding the review of applications by organizations seeking to achieve social welfare status.

But there is a limit to how much we can do in finding cost efficiencies. This year, we reached the point of having to make very critical performance tradeoffs, which have had a negative impact on service, enforcement, and IT. The funding cuts have also limited our ability to work toward giving taxpayers a more complete online filing experience. We think taxpayers ought to have the same level of service from the IRS that they now have from their financial institutions, whether it is a bank, brokerage or mortgage company.

We have been taking steps to try to close this year’s significant budget gap, and one of our major concerns, as you know, was the possibility of a shutdown of the IRS operations later this fiscal year to help close the budget gap. As a result of a review earlier this week, a meeting I had 2 days ago, it is now clear that our elimination of all hiring and overtime, along with cuts in other areas, has generated enough savings that we will no longer need to plan for a shutdown of the agency this fiscal year.

The President’s fiscal year 2016 budget request for the IRS, which totals, as noted, \$12.9 million, would help the Agency move ahead in all of these critical areas. For example, we would be able to bring our level of phone service up from the current 43 percent to 80 percent. We would also significantly increase enforcement and collection activities, generating over \$2 billion more in increased government revenues. And we would be able to take steps toward building a more modern interface between the agency and taxpayers.

I understand and appreciate the concerns raised over the past few years about activities at the agency. But I took this job 15

months ago because I also understand the critical role the IRS plays in the lives of taxpayers and in the collection of revenues that fund the government. I know I speak for the thousands of professional, experienced, and dedicated employees of the agency when I say we are committed to working with you and the other Members of Congress to lead the agency effectively and appropriately into the future. But we need your help and support if we are going to be successful.

That concludes my statement, and I would be delighted to take your questions.

[The information follows:]

**WRITTEN TESTIMONY OF
JOHN A. KOSKINEN
COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
ON THE IRS BUDGET
MARCH 18, 2015**

INTRODUCTION

Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the IRS' budget and current operations.

After 15 months as IRS Commissioner, it remains an honor for me to lead this great institution. My respect for the agency's role and admiration for its workforce continue to grow. I'm pleased to report the 2015 tax filing season opened on schedule on January 20th, and is going well so far.

Opening the current filing season on schedule was a major accomplishment, given the challenges we faced. I attribute this achievement to the dedication, commitment and expertise of the IRS workforce. Along with normal filing season preparations, there was a significant amount of extra work to get ready for tax changes relating to the Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA). We also had to update our systems to reflect the passage of the tax extender legislation in December.

Even with the demonstrated capacity of our workforce to meet these challenges to successfully open filing season on time, I remain deeply concerned that the significant reductions in the IRS budget will degrade the agency's ability to continue to deliver on its mission during filing season and beyond. In fact, one of my highest priorities since becoming Commissioner has been to advise Congress about the ramifications of continued substantial cuts to our funding, and that is what I will focus on in my testimony today.

IRS funding has been reduced \$1.2 billion over the last five years, dropping to \$10.9 billion in Fiscal Year (FY) 2015. That level is \$346 million below the enacted level for FY 2014. But the total reduction from FY 2014 is actually closer to \$600 million when accounting for nearly \$250 million in mandatory costs and inflation.

The IRS is now at its lowest level of funding since FY 2008. When inflation is taken into account, the current funding level is comparable to that of 1998. Since

then, however, the number of individual and business tax filers has increased by more than 30 million, or 23 percent, along with an increase in the number of legislative mandates the IRS is required to implement.

IMPACT OF BUDGET CUTS ON FY 2015 OPERATIONS

There is simply no way around the severity of the budget cuts without taking some difficult steps. Essentially, we are at the point of having to make very critical performance tradeoffs. I recently worked with IRS senior leadership to determine how to allocate our limited resources based on our final FY 2015 budget numbers. We reviewed our operations to determine where we could make cuts that would have the smallest possible effect on taxpayers and tax administration. In making these decisions, we strove to maintain a balanced and fair approach, keeping in mind the needs of both service and enforcement, to avoid overly harming one part of our mission in the attempt to maintain another.

Let me now describe for this Subcommittee the difficult decisions we made to absorb the latest round of budget cuts, and the ramifications of those decisions.

- ***Delays to critical information technology (IT) investments of more than \$200 million.*** We anticipate these delays will reduce taxpayer service and cost-efficiency efforts, as well as reduce outside contractor support for critical IT projects. For example, we are being forced to delay replacement of aging IT systems. While we have made some progress in modernizing these systems, more than 50 applications are still in need of replacement. Delays to our IT investment harm our ability to protect taxpayer data; combat tax fraud and schemes; address non-compliance that contributes to the tax gap; and fight against cyber-attacks. In addition, we will not be able to invest upfront money to develop future capabilities, such as improved web services that would enable taxpayers to more easily obtain information and improve their interaction with the IRS.
- ***Enforcement cuts of more than \$160 million.*** We estimate the agency will lose through attrition about 1,800 key enforcement personnel during FY 2015 we will not be able to replace. We anticipate the outcome will be fewer audits and fewer resources focused on collection. We estimate that as a result of these enforcement cuts the government will lose at least \$2 billion in revenue. In addition to this loss, the curtailment of enforcement programs is extremely troublesome because these programs help create a deterrent effect that is the key to preserving high levels of voluntary compliance and maintaining the integrity of the nation's tax system.
- ***Reductions in staffing during filing season totaling more than \$180 million.*** Normally, the IRS uses employee overtime and temporary staff to provide the extra resources needed during the busy filing season. However, the IRS will be reducing overtime and seasonal staff hours

during FY 2015. We anticipate these cuts will result in delays in refunds for some taxpayers. People who file paper tax returns could wait an extra week — or possibly longer — to see their refund. Taxpayers with errors or questions on their returns that require additional manual review will also face delays in getting their refunds. It is also expected taxpayers will have to wait longer to get answers to their questions from the IRS. Responses to written correspondence will take longer, and taxpayers will have more difficulty getting through to the IRS on the phone and in person. Our phone level of service (LOS) was at 54 percent at the start of the current filing season. As we have gotten further into the filing season, LOS has continued to deteriorate, dropping below 50 percent. This measure means fewer than half of the people who try to reach the IRS by phone will end up getting through. That level is significantly below the FY 2014 average of 64 percent, which was itself below desired levels. Those who do reach the IRS are facing extended wait times that are unacceptable to all of us.

- **Continuing the agency hiring freeze.** The IRS is extending the exception-only hiring freeze that began in FY 2011 through FY 2015. As a result, and assuming normal attrition rates, the IRS expects to lose approximately 3,000 additional full-time employees in FY 2015. That level would bring the total reduction in full-time staffing since FY 2010 to over 16,000. This reduction in staffing will have continued negative effects on taxpayer service and enforcement as noted above.

Even with all of these reductions, the IRS still faces a significant budget shortfall for FY 2015. We have taken and continue to take steps to try to close this gap. As stated in the past, one of our concerns has been the possibility of a shutdown of IRS operations later this fiscal year. We have been monitoring the situation on a regular basis, and at this point we are hopeful we can avoid a shutdown of the agency this fiscal year.

In discussing the agency's budget, it is important to point out the IRS has been working and continues to work to find savings and efficiencies wherever possible, so as to absorb the reductions to our funding that have occurred since FY 2010. This effort has not been easy, because labor costs are by far the largest portion of the IRS budget. In fact, approximately 75 percent of our budget represents staffing, which is critical to providing adequate levels of taxpayer service and maintaining robust compliance programs. Moreover, it is not possible to shift enforcement personnel into service jobs, or vice versa, without providing them with substantial training, which, of course, is resource-intensive.

Nonetheless, the IRS has for several years made considerable effort to find efficiencies in our operations. For example, the IRS has implemented significant reductions in its non-labor spending.

The agency reduced annual travel and training expenditures by \$248 million, or 74 percent, between FY 2010 and 2014. Any such expenses of \$50,000 or more must be reviewed and approved personally by me and then by the Treasury Department. Therefore, at this point, I am satisfied there are no excesses in these areas, and there have been none for quite some time.

Additionally, in an effort to promote more efficient use of the Federal Government's real estate assets and to generate savings, in 2012 the agency began a sweeping office space and rent reduction initiative. We estimate these measures have reduced rent costs by more than \$47 million each year and reduced total IRS office space by more than 1.8 million square feet.

We will continue our efforts to find savings and efficiencies wherever we can. For example, we continue to evaluate our space needs, and under the processes we now have in place, each time a lease comes up for renewal we carefully consider whether to renew it. In fact, a few weeks ago the agency cancelled a lease in New York City, which will save us about \$4.5 million in FY 2015, and \$15 million over the life of that lease. We will continue to review all upcoming real estate transactions to make sure we are as cost effective as possible.

But there is a limit to how much we can do in the area of finding cost efficiencies. And as I said in my testimony to the Appropriations Committees almost one year ago, the cuts to the IRS are so significant that efficiencies alone cannot make up the difference.

THE ADMINISTRATION'S FY 2016 BUDGET REQUEST

The President's FY 2016 Budget provides \$12.93 billion for the IRS. This amount includes \$12.3 billion in base discretionary resources, an increase of \$1.3 billion from FY 2015, allowing us to make strategic investments to continue modernizing our systems and improving service to taxpayers, and reduce the deficit through more effective enforcement and administration of tax laws. The Budget also proposes a \$667 million program integrity cap adjustment to support program integrity efforts aimed at restoring enforcement of current tax laws to acceptable levels and to help reduce the tax gap. This multi-year effort is expected to generate \$60 billion in additional revenue over the next ten years at a cost of \$19 billion over that 10 year period, thereby reducing the deficit by \$41 billion.

It is fair to ask what value the American taxpayer would receive for this increase in funding requested by the President. Let me detail for you several notable examples of how the IRS intends to spend these additional funds:

Improve taxpayer service: \$301.5 million. This additional funding will allow the IRS to meet the expected increase in demand for taxpayer services in FY 2016, through the hiring of approximately 3,000 additional staff to increase the telephone level of service to an acceptable level of 80 percent. Resources are

also needed to meet the increased demand for taxpayer face-to-face assistance resulting from ACA implementation; expand staffing to assist with managing the ACA submission processing workload; and provide advanced technology to electronically receive amended returns.

Leverage new technologies to advance the IRS mission and enhance service options for taxpayers: \$107.8 million. This additional funding combines two programs that leverage new technologies, one of which (\$91.6 million) will assist the IRS in advancing its mission generally and another (\$16.2 million) that will enhance service options. Together the programs will provide the foundation for the IRS to develop, over several years, an IT-based strategy that will help improve the online filing experience for taxpayers. The strategy will focus on enhancing the filing experience by understanding taxpayers' service channel preferences. By creating new digital capabilities and reducing the burden on taxpayers, the strategy will allow for earlier and more efficient engagement between the IRS and taxpayers. This initiative will improve the speed and convenience of interacting with the IRS. The funding will be used to implement a new Enterprise Case Management (ECM) solution for performing standard case management functions across the IRS, which will allow us to operate more efficiently; expand the capabilities of the existing Customer Account Data Engine (CADE 2) database; provide secure digital communications between taxpayers and the IRS; and continue development of the fraud detection, resolution, and prevention Return Review Program (RRP).

Improve upfront identification and resolution of identity theft returns: \$18.9 million. This additional funding will strengthen the integrity of the tax system by improving the IRS' ability to detect and prevent improper refunds. Resources will allow the IRS to expand programs to prevent identity theft-related refund fraud, protect taxpayer identities and assist victims of identity theft.

Implement ACA: \$490.4 million. This additional funding, the majority of which is for required information technology upgrades, will allow the IRS to increase efforts to ensure compliance with a number of tax-related provisions of the ACA, including the premium tax credit and individual shared responsibility provision. The funding will provide enhanced technology infrastructure and applications support, and allow necessary, major modifications to existing IRS tax administration systems. A portion of the funding also addresses new audit requirements related to the employer shared responsibility provision.

Implement FATCA: \$71.0 million. With this additional funding, the IRS will invest in advanced technology to allow the agency to continue implementing FATCA, which in turn will provide more information to us on offshore accounts of U.S. citizens. FATCA includes new reporting and withholding requirements for foreign financial institutions. In order to properly process and analyze the data we receive as a result of these new requirements, the IRS will need to build new technology systems and modify existing systems. This initiative provides funding

for enforcement staff to implement FATCA's new reporting and disclosure requirements, and thus will allow the IRS to address foreign withholding compliance and expand coverage of international tax return filings. As a result of these activities, we project additional annual enforcement revenue of \$155.1 million once new hires reach full potential in FY 2018, an ROI of \$2.3 to \$1.

Sustain critical IT infrastructure: \$188.5 million. This initiative will restore resources for mainframes, servers, laptops, network devices, and communication equipment to keep IT infrastructure (hardware and software) current for existing and newly developed IRS IT systems. The IRS' IT division provides technology services and solutions that drive effective tax administration, improve service, modernize systems, and ensure the security and resiliency of IRS information systems and data. With this funding, the IRS will be able to enhance systems security to help anticipate and protect against evolving threats; increase reliability of enterprise infrastructures to support increased electronic filing; increase the use of cloud and virtual environments; and expand the use of the next generation of advanced telecommunication technologies.

Program integrity enforcement and compliance increases. Enactment of the program integrity cap adjustment proposal would facilitate funding for high return on investment (ROI) revenue-producing enforcement and compliance initiatives, including the following:

- **Prevent refund fraud and identity theft: \$82.2 million.** This additional funding will provide for additional staffing and investments in advanced technologies needed to handle the increased workload associated with identity theft and refund fraud. Specifically, the funding will help the agency improve upfront identification and resolution of identity theft; address the backlog of identity theft cases associated with pre-refund and post-refund compliance activities; recover erroneous refunds due to fraud; prevent prisoner tax refund fraud; stop refund fraud by limiting the number of refunds that can be sent to a single bank account; continue the expansion of the specialized Criminal Investigation (CI) Identity Theft Clearinghouse that processes identity theft leads; and invest in information technology projects to reduce identity theft and stop fraudulent tax refunds before they are paid. We project that investment in these activities will protect nearly \$1 billion in revenue once the new hires carrying out these activities reach full potential in FY 2018, a return on investment (ROI) of \$13.2 to \$1.
- **Address offshore tax evasion: \$40.7 million.** This additional funding will allow us to expand our efforts to identify and pursue U.S. taxpayers with undisclosed offshore accounts. Funding will allow the IRS to: promote voluntary compliance with U.S. laws through strategic enforcement actions directed at identifying U.S. taxpayers involved in abusive offshore tax

schemes through banks, other financial institutions and third party structures; expand information gathering and data analysis to identify promoters or facilitators of abusive offshore schemes; and expand the pursuit of international tax and financial crimes as well as grow the IRS attaché presence. We estimate these activities will produce additional, direct annual enforcement revenue of approximately \$159.6 million once the new hires carrying out these activities reach full potential in FY 2018. That is an ROI of \$3.7 to \$1.

- **Increase audit coverage: \$161.8 million.** This additional funding will allow the IRS to hire additional personnel to improve our examination efforts in regard to individuals. Tight budget constraints have eroded the examination staff available to conduct audits, causing the individual audit coverage rate to decline below 0.9 percent. Reduced coverage causes increased risk to the integrity of the voluntary compliance system. The funding will help the agency begin the multiyear process of reversing that trend, by providing additional field employees. The funding will also allow the agency to increase individual and business document matching programs to identify and reduce income misreporting. These activities are expected annually to produce additional enforcement revenue of approximately \$1.3 billion once the new hires reach full potential in FY 2018, an ROI of \$8 to \$1.
- **Improve audit coverage of large partnerships: \$16.2 million.** This additional funding will allow the IRS to increase the number of agents with specialized knowledge in partnership law, strengthen enforcement activities relating to flow-through entities, and improve compliance by enhancing IRS processes and procedures with respect to Tax Equity and Fiscal Responsibility Act (TEFRA) partnerships. As a result, we expect to produce additional annual enforcement revenue of approximately \$129.1 million once the new hires reach full potential in FY 2018, an ROI of \$7.6 to \$1.
- **Enhance collection coverage: \$122.8 million.** This additional funding will help the IRS work its collection inventory and bring taxpayers who fail to pay their tax debts into compliance. IRS will address growing collection case inventories and call volumes that have resulted from reduced staffing levels in recent years; increase coverage of the growing number of employment tax collection cases with respect to business taxpayers; provide resources to reach out to taxpayers earlier in the collection process; help taxpayers experiencing economic hardship resolve their liabilities through the Offer in Compromise (OIC) program; and improve the capability to identify nonfilers of business returns. As a result of these activities, we project additional annual, direct enforcement revenue of approximately \$1.2 billion once new hires reach full potential in FY 2018, an ROI of \$9.0 to \$1.

- **Improve efforts in the tax-exempt sector: \$23.5 million.** This additional funding will help the IRS to build and maintain public trust by: anticipating and addressing the tax-exempt sector's needs; encouraging voluntary compliance; and effectively enforcing the law to ensure compliance. The IRS will be able to accomplish the following: enhance the streamlined application process for exempt organizations seeking tax-exempt status; protect participants in retirement plans and their assets, which total more than \$23 trillion; provide voluntary correction opportunities related to employment taxes and retirement plans; improve service and compliance by integrating three separate determination application systems into one end-to-end system; and focus resources on areas with the greatest risk, so resources in the Tax Exempt and Government Entities arena are developed and deployed appropriately.
- **Pursue employment tax and abusive tax schemes: \$17.2 million.** This additional funding will improve our efforts in the core enforcement areas of corporate fraud, employment tax, and abusive tax schemes, which will increase the number of convictions and assessments of unpaid tax. A portion of the funding will be used to acquire computer software that will enable the IRS to detect corporate fraud and abuse. With this software tool, the IRS will be able to identify schemes by linking together multiple potentially fraudulent returns or information items. These resources will improve the sharing of information among the agency's operating divisions, and expand the IRS' capability to identify significant tax cases.
- **Consolidate and modernize IRS facilities: \$85.5 million.** This initiative will provide space renovation resources needed to alter and reduce office space throughout the IRS inventory and realize an estimated annual rent savings of \$23 million. The IRS plans to reinvest the rent savings from this initiative to fund rent increases for the remaining buildings and for other new space reduction projects. Space reductions and consolidation strategies include reducing workstation size in accordance with revised National Workplace Standards; workspace sharing for frequent teleworkers and employees who work outside of their assigned post of duty more than 80 hours per month; realignment of occupied workspace; and consolidation of vacant workspace.
- **Improve IRS financial accounting systems: \$12.2 million.** This additional funding will help the IRS with more timely and accurate reporting of data on the revenue we collect. The funding will also be used to make necessary system and programming changes to comply with various federal mandates, and to stay current with internal changes made to IRS's tax processing systems for tax administration that also affect financial reporting.

Along with the funding request, we are also asking for Congress's help legislatively. In that regard, let me highlight several important legislative proposals in the President's FY 2016 Budget that would help to narrow the tax gap and reduce erroneous and fraudulent refunds, including fraud resulting from identity theft. Overall, the legislative proposals to strengthen tax administration, improve compliance by business, and expand information reporting would increase revenue by \$84 billion over the next 10 years, of which \$60 billion would come from enacting program integrity cap adjustments.

- **Acceleration of information return filing due dates.** Under current law, most information returns, including Forms 1099 and 1098, must be filed with the IRS by February 28 of the year following the year for which the information is being reported, while Form W-2 must be filed with the Social Security Administration (SSA) by the last day of February. The due date for filing information returns with the IRS or SSA is generally extended until March 31 if the returns are filed electronically. The Budget proposal would require these information returns to be filed earlier, which would assist the IRS in identifying fraudulent returns and reduce refund fraud, including fraud related to identity theft.
- **Correctible error authority.** The IRS has authority in limited circumstances to identify certain computation errors or other irregularities on returns and automatically adjust the return for a taxpayer, commonly known as "math error authority." At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific, newly enacted tax code amendments. The IRS would be able to significantly improve tax administration – including reducing improper payments and cutting down on the need for costly audits – if Congress were to enact the Budget proposal to replace the existing specific grants of this authority with more general authority covering computation errors and incorrect use of IRS tables. Congress could also help in this regard by creating a new category of "correctible errors," allowing the IRS to fix errors in several specific situations, such as when a taxpayer's information does not match the data in certain government databases.
- **Authority to regulate tax return preparers.** The Budget proposal would provide the agency with explicit authority to regulate all paid tax return preparers. The regulation of all paid tax return preparers, in conjunction with diligent enforcement, would help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system.
- **Preparer penalty.** Under current law, the penalty imposed on preparers for understatement of tax on a federal return due to an unreasonable position taken on the return is the greater of \$1,000 or 50 percent of the income derived by the preparer from preparation of the return. A separate

penalty can be imposed if the understatement is due to the preparer's willful or reckless conduct. That penalty is the greater of \$5,000 or 50 percent of the income derived by the preparer from preparation of the return. The Administration's proposal would increase the penalty in cases of willful or reckless misconduct to the greater of \$5,000 or 75 percent of the income derived by the preparer (instead of 50 percent). This proposal is necessary because in many cases, 50 percent of income derived by the preparer is far greater than the fixed dollar penalties imposed, so that, under the present penalty regime, preparers who engaged in reckless or willful conduct would end up paying the same dollar penalty as preparers whose conduct did not rise to that level.

- **Due diligence.** Return preparers who prepare tax returns on which the Earned Income Tax Credit (EITC) is claimed must meet certain due diligence requirements. In addition to asking questions designed to determine eligibility, the preparer must complete a due diligence checklist (Form 8867) for each taxpayer, which is filed with the taxpayer's return. The Administration's proposal would extend the due diligence requirements to all federal income tax returns claiming the Child Tax Credit (CTC) and the Additional Child Tax Credit. The existing checklist would be modified to take into account differences between the EITC and CTC.

There are a number of other legislative proposals in the Administration's FY 2016 Budget request that would specifically assist the IRS in its efforts to combat identity theft. They include the following:

- Providing Treasury and the IRS with authority to require or permit employers to mask a portion of an employee's Social Security Number (SSN) on W-2s, an additional tool that would make it more difficult for identity thieves to steal SSNs;
- Adding tax-related offenses to the list of crimes in the Aggravated Identity Theft Statute, which would subject criminals convicted of tax-related identity theft crimes to longer sentences than those that apply under current law; and
- Adding a \$5,000 civil penalty to the Internal Revenue Code for tax-related identity theft cases, to provide an additional enforcement tool that could be used in conjunction with criminal prosecutions.

In discussing legislative proposals in the President's FY 2016 Budget, it is also important to mention streamlined critical pay authority. Though this authority rests with the committees of jurisdiction over Title 5 of the United States Code, in the past the vehicle for changes and updates of the authority has been appropriations bills. The IRS Restructuring and Reform Act of 1998 increased the

IRS' ability to recruit and retain a handful of key executive-level staff by providing the agency with streamlined critical pay authority. This authority allowed the IRS, with approval from Treasury, to hire well-qualified individuals to fill positions deemed critical to the agency's success, and that required expertise of an extremely high level in an administrative, technical or professional field. This authority expired at the end of FY 2013, and the President's FY 2016 Budget proposes reinstating it.

The agency has already lost or will soon lose several senior experts in areas such as international tax, IT cyber security, online services and analytics support. Streamlined critical pay authority is an invaluable tool in our effort to replace them with people of the same high caliber expertise. It is my hope this critical program, which ran effectively for 14 years before it expired, will be reinstated.

CRITICAL NEED TO FURTHER MODERNIZE IT SYSTEMS

In looking to the future, we believe it is not an option to stay at our current level of funding, given the extent to which both taxpayer service and enforcement will suffer as a result. It is especially troubling to me these cuts prevent us from fully improving and modernizing our IT infrastructure and operations support. This situation hurts taxpayers and the entire tax community.

Earlier in this testimony I described some examples of IT projects that must be deferred as a result of budget reductions in FY 2015. But the problem is much broader. We are operating with antiquated systems that are increasingly at risk, as we continue to fall behind in upgrading both hardware infrastructure and software. Despite more than a decade of upgrades to the agency's core business systems, we still have very old technology running alongside our more modern systems. This compromises the stability and reliability of our information systems, and leaves us open to more system failures and potential security breaches.

In regard to software, we still have applications that were running when John F. Kennedy was President. Also, we continue to use a decades-old programming language that was already considered outdated back when I served as chairman of the President's Council on Year 2000 Conversion, and it is extremely difficult to find IT experts who are versed in this language. I give our IT employees a tremendous amount of credit, as keeping things going in the face of these challenges is really a major accomplishment.

It is important to point out the IRS is the world's largest financial accounting institution, and that is a tremendously risky operation to run with outdated equipment and applications. Our situation is analogous to driving a Model T automobile that has satellite radio and the latest GPS system. Even with all the bells and whistles, it is still a Model T. Our core IT systems are not sustainable

without significant further investment over the next few years, and I look forward to working with you on this matter in the future.

The concerns I have about the IRS' IT funding level relate not only to the negative effect these cuts have on the present operations of the agency, but also the effect on our ability to advance the agency into the future and provide a more up-to-date and efficient tax filing process for the taxpaying public.

The experience taxpayers have with the IRS should give them confidence in knowing they can take care of their tax obligations in a fast, secure, transparent, and consistent manner. This goal is not unrealistic. We're not trying to go to the moon. We're simply saying people should expect the same level of service when dealing with the IRS as they have now from their financial institution, whether it's a bank, brokerage, or mortgage company.

To the extent possible within our budget constraints, the IRS has already made some significant improvements in its technology to better serve taxpayers. For example, one of the most popular features on IRS.gov is the "Where's My Refund?" electronic tracking tool, which reduces phone traffic the IRS receives regarding questions about refunds. Taxpayers have already used this tool more than 154 million times so far this year.

Another good example is IRS Direct Pay, which provides taxpayers with a secure, free, quick, and easy online option for making tax payments, thereby reducing the need for the IRS to process payments by check. Still another example is Get Transcript, a secure online system that allows taxpayers to view and print a record of their IRS account in a matter of minutes, which saves taxpayers time and reduces IRS resources needed to process paper requests for transcripts.

While these are important steps forward, more needs to be done. We have begun to ask ourselves what the online filing experience ought to look like three to five years down the road, and what it would take to make that a reality. In the future, most things taxpayers do to fulfill their tax obligations could be done virtually, and there would be much less need for in-person help or for calling the IRS. The idea is that taxpayers would have an account at the IRS where they could log in securely, get all of the information about their account, and interact with the IRS as needed.

Improving service to taxpayers in this way can also help us on the compliance side of the equation. In this future state, the IRS could identify problems in tax returns shortly after a return is filed, and interact with taxpayers as soon as possible. That way, those issues could be corrected while tax records are available without costly follow-up contact or labor-intensive audits.

While the President's FY 2016 Budget makes important investments in IT to help build this approach, it is not an approach we will be ready to fully implement within the next year. We want to make it a reality in the future, some years from now. Of course, how quickly we can deliver on this vision will depend on future levels of agency funding.

CONCLUSION

Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee, thank you again for the opportunity to discuss the IRS budget and current operations. Given the negative effects we are already seeing on our ability to deliver on our mission, I believe it is vital for us to find a solution to our budget problem, so that the IRS can be put on a path to a more stable and predictable level of funding. I look forward to working with Congress to do just that. This concludes my statement, and I would be happy to take your questions.

Commissioner John Koskinen



John Koskinen is the 48th IRS Commissioner. As Commissioner, he presides over the nation's tax system, which collects approximately \$2.4 trillion in tax revenue each year. This revenue funds most government operations and public services. Mr. Koskinen manages an agency of about 90,000 employees and a budget of approximately \$11 billion.

In his role leading the IRS, Mr. Koskinen is working to ensure that the agency maintains an appropriate balance between taxpayer service and tax enforcement and administers the tax code with fairness and integrity.

Prior to his appointment, Mr. Koskinen served as the non-executive chairman of Freddie Mac from 2008 to 2012 and its acting chief executive officer in 2009. Previously, Mr. Koskinen served as President of the U.S. Soccer Foundation, Deputy Mayor and City Administrator of Washington D.C., Assistant to the President and Chair of the President's Council on Year 2000 Conversion and Deputy Director for Management at the Office of Management and Budget. Mr. Koskinen also spent 21 years in the private sector in various leadership positions with the Palmieri Company, including President and Chief Executive Officer, helping to turn around large, troubled organizations. He began his career clerking for Chief Judge David L. Bazelon of the DC Circuit Court of Appeals in 1965, practiced law with the firm of Gibson, Dunn and Crutcher and served as Assistant to the Deputy Executive Director of the National Advisory Commission on Civil Disorders, also known as the Kerner Commission. Mr. Koskinen also served as Legislative Assistant to New York Mayor John Lindsay and Administrative Assistant to Sen. Abraham Ribicoff of Connecticut.

Mr. Koskinen holds a Law Degree from Yale University School of Law and a Bachelor's Degree from Duke University. He also studied International Law for one year in Cambridge, England. He and his wife Patricia have two grown children and live in Washington, DC.

ABLE ACT AND 501(C)(4) REGULATIONS

Mr. CRENSHAW. Well, thank you very much.

Let me start the questions. You know, I mentioned the ABLE Act in my opening statement. You mentioned ABLE Act. That is something new that you are going to have to do to write the rules and regulations by the middle of June; that is 6 months away. Now, as you probably know, the ABLE Act is patterned after what we call a 529, that is where parents can set aside money in a tax-free savings account, let it grow, and as long as they use it to go to college.

So it seems to me that writing regulations that are consistent with what you already have in terms of the 529 shouldn't be a massive undertaking. So I hope that you can work on that and get that done in a timely fashion. Because on the other hand, there is something called the 501(c)(4) regulations that are not statutory mandated, but if you recall, when we had all the problems with the extra scrutiny that some of the tax-exempt organizations were getting, IRS decided they were going to redraft the 501(c)(4) regulations.

And, as you know, the regulations were put out there, and there is a lot of discussion about that. And at the end of the day, there were over 150,000 comments. And that regulation tended to offend just about everybody, on the left, on the right, nobody liked it. And so I guess that has been set aside. But one of the concerns that people had was that if those regulations suppressed what people would consider to be freedom of expression, that wouldn't be a good thing. And they were criticized, again, from the left and the right, because of that.

So now that as you, I understand it, are going to redraft those rules and regulations, the concern was in 2013 that they were going to be out there right about election time and people would be concerned about how they would be perceived under this new regulation. Now we are past 2014. Now 2016 elections stare us in the face. And there is some concern that are we going to go through this process again? Are we going to put that regulation out there right about election time? And people are going to be concerned that somehow these new regulations are going to impact their ability to be involved in the political process.

So my question is, what is the plan on this 501(c)(4) regulations? Are they going to be submitted right about election time and have a period of comment, or are they going to be put off until after the elections? Can you tell us exactly what is the plan on this next draft for the rules?

Mr. KOSKINEN. As I said in my testimony, we are going to do our best to meet the ABLE Act requirements and to get that program up and running. Policy is not our domain, but able is a good law. It will help a lot of people. It is not quite exactly the 529. It is the same framework, but, obviously, we have to determine with Social Security what appropriate disability payments are. We will have to get forms and regulations out. But you are right; it is not something that is brand new. We have already given guidance to the States that they can start developing those plans, and if the final rules vary a little, they will get transition protection. So we are encouraging the States to start working on those plans now.

With regard to the 501(c)(4) regulations, as you know, the previous draft was prepared before I showed up. My position has been from the start that any regulation needs to have several qualities. It needs to be fair to everybody. It needs to be clear and easy to administer. The IG reported that part of the problem that they found when they did their report on the management problems surrounding those applications was that the facts and circumstances test was vague, hard to administer, hard to understand.

Part of my concern has been if you are running a 501(c)(4) or (3), (5), (6) or (7), you need to have a clear roadmap so you know what you are doing. You don't have to worry that someone is going to come in, look over your shoulder and second-guess you. It is very complicated, you are right. We actually had about 160,000 comments. We have been going to great lengths to make sure they all get reviewed and treated carefully.

I have read about 1,200 pages of the best comments on both sides of all of those issues. It is complicated. We are looking at—I say to be fair—application across the entire spectrum. So it shouldn't be just (c)(4)s. We need to make sure, as Congress has legislated in all of these areas, that there is a consistent and appropriate framework for (c)(3), (c)(4), (c)(5), (c)(6)s, 527s.

Mr. CRENSHAW. And I appreciate all that, but just in terms of the timeframe—

Mr. KOSKINEN. Timeframe is, I haven't got a timeframe we are conscious of. I made it clear last year that we were going to be anxious not to do anything to interfere with the 2016 elections. This is a change that will last for a long time. I think it is important for people to understand it, be comfortable with it, understand it is fair. And so our goal is not to do anything that looks like we are trying to impact the next election.

Mr. CRENSHAW. But you don't know, you don't have a timeframe to say we are going to publish the next draft in the next 6 months or next year? You got any idea of when you are going to do that?

Mr. KOSKINEN. No. We had hoped actually to have made more progress than we have, but we are trying to make sure that we do it right. I have talked to several very interested Congressmen and Senators and told them we are not planning on surprising anyone. When we move this forward, even as we are developing the final forms, my proposal and plan is to talk to you, Congressman Ryan, Senator McConnell, and others who are interested.

I think people actually may—there has been a concern, on the one hand, that there are people who think all political activity ought to be covered.

Mr. CRENSHAW. Yeah, I understand that.

Mr. KOSKINEN. Anyway, so the timing. The answer is I don't have a clear timeline for you. I would like to get it out. It will then have 90 days for comment. We have committed to hold public hearings.

Mr. CRENSHAW. The only thing you can tell me is that you hope it won't impact the 2016 elections, but we don't know that for sure?

Mr. KOSKINEN. I don't control the whole process. It is a joint venture with the Treasury Department and the IRS, but we have a commitment that we do not plan to do anything to impact the 2016

elections. It should not be motivated by politics, and it shouldn't impact any particular election—

Mr. CRENSHAW. I appreciate that, but I also want to say, the ABLE Act that we talked about, that is a statutory mandate. Congress said go do that by June, okay. We didn't tell you to go do the 501(c)(4). You want to do that, and I hope you will get your priorities right, do what the statute says, and then if you have time, you can do the 501(c)(4)s somewhere along the way.

Mr. KOSKINEN. As I have said on numerous occasions, we implementation statutory mandates. We are focused on implementing the ABLE Act. We also have other statutory mandates. I know Chairman Rogers noted that we haven't got much funding for the Affordable Care Act. We don't have a choice upon implementing FATCA or the Affordable Care Act. They are all statutory mandates.

Mr. CRENSHAW. Thank you very much. I am out of time. I want to turn to my Ranking Member Mr. Serrano for any questions.

Mr. SERRANO. Thank you so much. I am really interested in your concern about the impact on the next election because the gentleman who could take credit for it is not going to run for reelection. We are going to have a new Presidential election. So it is really interesting who it would affect or help in any way.

BUDGET CUTS

For 2015, Commissioner, Congress put the IRS at below the sequester level with a reduction of \$346 million at the fiscal year 2014 level. Since 2010, the IRS' funding has been cut by \$1.2 billion or 10 percent. When adjusted for inflation, the IRS is now down to 1998 levels. I would like to ask you a question in three parts: What personnel actions do you anticipate having to take in response to these cuts? Secondly, what do you believe the long-term impacts of these cuts will be? And, lastly, how does your request of \$12.3 billion begin to repair the damage done by these cuts?

Mr. KOSKINEN. Thank you. I frequently refer to us as having been double sequestered. After the sequester went into effect and cuts were across the board, all the major agencies except for the IRS were restored to their pre-sequester levels. So we operated at the post-sequester level before the additional cut last year in our budget. So we have actually had two cuts while other major agencies are basically at the pre-sequester level.

The impact is 75 percent of our budget is personnel. So as we get cut, we have no choice but to cut personnel. We have lost 13,000 people since 2010. Our estimate is—and part of the way we are dealing with the cut this year—is we are going to lose another 3,000 people. So we will have 16,000 fewer people. That means we have fewer people answering the phones. We are trying to get everybody not to call and try to get them onto our Web site.

We will have, over that period of time, 5,000 fewer revenue agents, officers, criminal investigators. So our rate of audit is dropping. My concern is that it is not just a question of how much money we collect. We collect \$50 billion to \$60 billion with our own activities. It is, in fact, that enforcement and taxpayer services are two sides of a compliance coin. And what the real number is we should all be focusing on, that I am concerned about, is that \$3 tril-

lion that we collect. We are a tax-compliant society, but we are much more compliant if there is third-party information available to us and if people know we are going to use it.

If, as a result of these cuts, we have a 1-percent drop in the overall compliance rate in the United States, it will cost the government \$30 billion a year or \$300 billion over the 10-year measuring period that people have. My concern about the impact is that it is not a short-term impact—do we answer phone calls quickly enough or not—it is, over time, do the cuts ultimately corrode the compliance atmosphere in the United States in terms of people feeling the system is fair, that everybody is paying their fair share? If people begin to think that, because we are not enforcing the law adequately, some people are cheating, some people are getting away with it, it won't be helpful.

In terms of the budget, one of the things I would stress—I think the Chairman is correct, the comment about giving us a lack of money—our goal is not to go backwards. In other words, we ought not to be looking at this in terms of, if we get funding, we are going to go back to doing business the way we did before. One of the things I said in my prepared testimony, and I summarized briefly in my oral testimony is, we need to look at—and the Chairman is right—is becoming more efficient and trying to go forward.

And one of the things we spent a lot of time in the last year looking at is, what should the taxpayer experience be 3 to 5 years from now? What it can't be is still dealing with us on the phone all the time, having to walk into our sites, trying to figure out the right way to deal with us. People ought to be able to have an efficient way in the digital economy and the digital world in dealing with us the way they deal with their banks and with their financial institutions today.

So, as I say, we are not talking about going to the moon. And it is not as if we don't know how to do online applications. The "Where's My Refund" application, the "Get Transcript" application, the fact that you can do an online installment agreement means that we have started to move in that direction. And as I have detailed in my presentation on the budget, if we get additional funding, and particularly in the IT area, we will become more efficient.

So my goal is not to say, give us the money and we will add 16,000 people back to the IRS. The goal is, if we can get additional funding and support, we should be able to run the organization with the number of people we have. And we should be able to have better taxpayer service, and taxpayers should be more easily able to contact us. We should be able to help them fix their returns without amendments. They should be able to do it online.

So I think it is really a question—I agree with that totally—of are we going forward rather than looking back and asking how do we get back to where we were. The taxpayer advocate says, we should be doing more preparation of returns in our taxpayer assistance centers. Well, over time, those diminished to about 60,000. Our VITA centers do 3 million returns for people. We ought to move more people into the VITA centers. We ought to move more people online. We ought to get people off the phone, except for those who need to be on the phone because they can't find the answer to their complicated question online.

So my hope is to work with this committee. We need to solve the problems of the past. I couldn't agree more with both Chairman Rogers and Chairman Crenshaw about that. And I hope we are building a record you can see that we are solving those problems, whether they are in the budget language or not. But, also, I hope we can work with you trying to figure out what is the IRS of the future we are trying jointly to build together.

Mr. SERRANO. And that is my last comment. I think we have all, probably all of us on this panel, have experienced the changes in the last few years. I remember when filing meant sending in this envelope, you know, that you had to, include a return receipt and hope it would get there on time and that they would tell you that they got it. And now I sign papers and give a check—if I have to give a check—and then I don't see it again until it gets settled. So that is where we want to go, to give everybody an opportunity to do it efficiently, quickly.

But my last comment is, you are so right: If people begin to think that not everybody is being treated equally because we don't have the resources to look like we are or to actually do it, then you are going to have havoc all over the place. And that is not good for us; it is not good for the country; not good for your agency.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you. And let me just remind you, my distinguished Ranking Member, that with the appropriations that IRS received last year, they collected more revenue than ever in the history of the United States of America. Just a thought.

And the other thing I would just say, and I don't want to get into an exchange, but the 501(c)(4) regulation don't have anything to do with who is the President. They have to do with whether or not, I think, that first draft, a lot of people felt like was going to put a wet blanket on political participation. I don't think anybody wants that to happen. So I think they are working on that, and I am sure they will do well.

I want to recognize Chairman Rogers now.

EMPLOYEE MISCONDUCT

Chairman ROGERS. Thank you, Mr. Chairman.

Mr. Commissioner, as you are laying off people, I have a group that I would recommend be included in that pattern. Some 300 past employees of the IRS who have been forced out or left while under investigation for performance or misconduct issues, 300 of those people were rehired between January 2010 and September 2013. According to the IG's audit, 141 former employees with prior substantiated tax issues, including five who the IRS found had willfully failed to even file a tax return, were rehired.

Other substantiated issues from previous IRS employment included unauthorized access to taxpayer information, leave abuse, falsification of official forms, unacceptable performance, misuse of IRS property, off-duty misconduct, and so on; 300 of them rehired. Those should be the first ones laid off, it seems to me, as you are going through this process that you are. Twenty percent of those, by the way, that came back to work, that you rehired, had new conduct or performance issues. One in five of them that you rehired are back in trouble again.

I am no great administrator, but I think I see a chance here to make the world better. What do you think?

Mr. KOSKINEN. I agree. I have told the IG and, in fact, our formal response states that we have taken their recommendations.

As the IG noted, in that time period, there were 53,000 employees hired, so the 300 were a relatively small portion of the 53,000. Doesn't mean it isn't an important problem. Part of what it is, is the vast majority of those are seasonal or temporary employees that get hired during filing season. So the volume of people coming through is high.

But we have agreed with the IG that, in fact—and we are working with our personnel people in OPM and our lawyers to make sure that we stay within the law—but we agree. If you have had a prior serious performance or misconduct issue, you shouldn't be eligible for being rehired. As I say, the bulk of those people are temporaries. The time period was 2012, and, in fact, in 2012, we increased our focus on this, and we now agree with the IG that we should review this matter to try to do everything we can to make sure that we don't, in fact, repeat that practice.

Chairman ROGERS. Well, you know, it doesn't do your agency a lot of PR good out in the country.

Mr. KOSKINEN. I agree.

Chairman ROGERS. When people who pay taxes, see somebody as a tax evader trying to collect their taxes, you admit that is not very good PR—

Mr. KOSKINEN. Exactly. In fact, separately from this, there is the issue of tax compliance by our employees. And we have a compliance rate slightly above 99 percent, much higher than any other Federal agency, our employees take that seriously. They understand if you willfully don't pay your taxes, you are subject to dismissal.

And a question has been raised in the past, well, if you are not in compliance with your tax obligations, if you are in that small percentage, you shouldn't be eligible for performance awards. And we have adopted that policy and spread that around the agency. People understand that not only are you subject to discipline, but if you aren't current with your taxes, you are not eligible for a performance award as well.

And I agree with you that we need to—if I were a taxpayer, I agree the people collecting taxes ought to take it seriously and ought to be compliant. And our employees understand that. And I would stress, over 99 percent of them are compliant, and we monitor that every year and with every employee.

Chairman ROGERS. I would audit that more frequently than every year.

Mr. KOSKINEN. Well, they only pay taxes once a year, so it is a little hard to.

Chairman ROGERS. Yeah, well, there are other sins that many of them have committed that are immediately—

Mr. KOSKINEN. On the nontax issues, as I said, we agree with that, and we are going to do everything we can to ensure that while it was a relatively small number, the number really should be zero.

CUSTOMER SERVICE

Chairman ROGERS. Because of multiple poor management decisions and other matters, your budget has either been cut or held flat since 2010. Blame for long phone wait times and the decline in customer service is often placed on those budget cuts. We have heard that. However, nothing in the appropriations bill for your agency explicitly reduces funds for customer service. On the contrary, the taxpayer service account was increased in 2014 and not cut in 2015. Given that case, you have had plenty of money for customer service. How do you explain the decline in customer service?

Mr. KOSKINEN. Two things: First, as I explained to this committee last year, when I predicted that if we didn't get the additional money we were requesting, our service level was going to drop, we knew—and it has been true—that we would get a significant number of increased inquiries on the Affordable Care Act since this is the first year that the filing goes through. Secondly, as we advise the committee each year, we have user fees that we collect, subject to OMB review and approval, that we apply. Historically, we have applied somewhere close to \$200 million of the user fees to customer service.

Because of the underfunding or the zero funding for Affordable Care and FATCA, the only way we could implement those statutory mandates in the last few years, and particularly last year, was to move a significant part of that support for taxpayer service into the IT accounts because we needed \$300 million and got zero. We still left \$50 million of those user fees to apply to taxpayer services, but in effect, the taxpayer service account is \$100 million less this year than it has been in the past. We have 3,000—over this time-frame, 3,000 fewer people answering the phones.

But I would stress, one of our goals has been to try to become more efficient, try to provide more information and support for taxpayers not on the call service. I think in the long run, the answer to dealing with the call centers is not just more people; it is, in fact, to continue to provide alternatives so that people, in fact, don't feel they have to call. Most of us never call our bank. If you have a question, you just go online, look at your account, make an electronic communication. Airlines now penalize you if you call them for a reservation. They expect that you will do it efficiently online.

We need to get to that same space. I am concerned about taxpayer service, but, again, my point is, we shouldn't just put money into taxpayer service and keep doing business the same old way. As everybody agrees, we need to get to be more efficient and we need to give a taxpayer a better experience than having to wait in line, either for the phone or in our walk-in centers.

If we could get a system to run as efficiently as the private sector does, which is just a question of investment in IT, then the people calling the phones would be the people who really need to be there and our service level would go up even with the same level of employees. So I agree with you. It is not just a question of—and if we have more money—just putting people on the phones. We, at the same time, need to get them the information they need as efficiently as we can. Most people would much rather get it off the Web, download their forms off the Web.

Chairman ROGERS. Mr. Commissioner, I leave you with two words: Go Cats.

Mr. KOSKINEN. Well, as an old Kentuckian, for everybody else, I grew up about 5 miles outside of the Chairman's jurisdiction in Kentucky. I share that sympathy. Although, as a Duke guy, you know, I do have these mixed emotions about how this goes.

And then I am looking—Congressman Yoder promised me last year he was going to hang a Kansas flag outside his office on the building, and I don't see that there yet. But it is a great time of year.

Mr. CRENSHAW. Thank you very much.

And now I would like to turn to Mr. Quigley.

Mr. QUIGLEY. Thank you, Mr. Chairman.

Welcome, Commissioner. How are you?

Mr. KOSKINEN. I am having an interesting time in an interesting stage in my career.

DEFENSE OF MARRIAGE ACT

Mr. QUIGLEY. We understand.

I thought about the fact that after DOMA was struck down by the Supreme Court, this must have changed some of the work that your fine people do. Can you explain some of the changes and how they have impacted your workers and what we try to do for folks to educate taxpayers about the change? Obviously, there is filing status that many people have never had the ability to enjoy.

Mr. KOSKINEN. Right. With DOMA, as well as Affordable Care and other issues, tax extenders when they are passed, we have a very active program of reaching out to taxpayers to try to get them as much information as we can about everything. We have tax tips. We put out press releases. We do—I don't know how to Twitter, but we do Twitter. We have YouTube videos. All trying to make sure that it is as easy as possible that taxpayers now understand their circumstances. And, for DOMA, we have done that, trying to explain to taxpayers what the impact of the decisions are.

In short, from the standpoint of processing, if you are legally married and therefore eligible to file a tax return jointly, the filing and the processing of that goes smoothly. So the real issue has been to try to make sure taxpayers eligible to do that understand that. And so—

Mr. QUIGLEY. Were there questions from some constituents about whether they were eligible, given the fact that it is not applicable in every State?

Mr. KOSKINEN. That is right. And we have frequently asked questions. Again, we provide that on our Web site. We provide that in our information and our outreach. We have tax forms every year in which we try to make that clear, to make it easy for people to figure out whether they are eligible or not and to answer their questions. The questions are fairly straightforward, and thus far, we have had no indication that there is, you know, unnecessary confusion out there.

We do monitor, you know, what is going on during a filing season and try to pick up on both in our call centers what the questions are that we are getting asked to try to figure out, if people have a recurring set of questions, can we provide them that information

not just individually but as a group. So we adjust our Web site throughout the tax filing season. We put out, for instance, on tax scams and concerns about fraud and identity theft, we continue to put out updates.

FRAUD AND IMPROPER PAYMENTS

Mr. QUIGLEY. Well, and let me talk about that for a second, given our limited time. GAO report, the IRS is estimated to have paid out \$5.8 billion in fraudulent refunds last year. That is about a 60-percent increase over 2011. And if you could also comment on the improper payments EITC, you know, what are you doing about both issues?

Mr. KOSKINEN. On identity theft refund fraud, as GAO reported, we stopped about over \$20 billion of false returns. It is a battle right now with organized crime syndicates here and around the world. We have spent as much money as we could find to improve our IT filters and detections, but we are talking about people who are filing hundreds of returns and reverse engineering, trying to figure out what our filters are, and they adjust and then we adjust. And so it is a real battle at a very high level.

Mr. QUIGLEY. You said “infrastructure,” is that investments in IT, or do you have the ability you just have to keep up with them?

Mr. KOSKINEN. We actually are moving more slowly than we would like, and the budget makes clear the amount of money that would help us deal with this, but even additional investments are never going to get it to zero. We are dealing with organized criminals.

On EITC improper payments, Chairman Rogers raised that point, it is a problem I am very concerned about. Of all the issues we deal with, we made great progress in identity theft and refund fraud. We have made progress implementing the filing seasons so that they go well and we made progress implementing FATCA and ACA. We have not made progress on EITC. We have had a high level of improper payments for 10 years even with all of the things we have tried.

Over a year ago, I said I want everybody who knows anything about EITC to come to my office, and we are going to talk about why is it that we can't make a dent in the problem. And, ultimately, what we came away with is that we need legislative help. We need your help. We need to get W-2s earlier so we can match them up at the front end as well.

We need what is called correctable-error authority. We know when there are errors in these returns, especially compared against our dependent database, but the only way we can make a change under the present law is to do an audit. So we do almost 500,000 audits in the EITC area, but we have 27 million participants.

We know there are hundreds of thousands of additional returns where we know there is a mistake, but we can't change it without an audit, and we simply can't audit our way out of the problem. If we had correctable-error authority, we could make the correction, send the corrected return back to the taxpayer. They could then say, you know, I have really got three kids as opposed to one child, but we would be able to actually move it much farther along.

Mr. QUIGLEY. And just to finish the thought—and I hear what you are saying—is it just—to discourage this, this is really a question of whether they think they are going to get caught. Are the penalties severe enough, or they just don't think they are going to get caught?

Mr. KOSKINEN. It is a complicated statute. So if somebody wanted to streamline the statute, that would help. But what you have is some tax preparers who mean well and simply are making honest mistakes, and you have some tax preparers who are crooks, who are advertising, come with me, and I will get you a bigger refund, and they are consciously filing false returns in effect. I am confident that we will catch some of them but not all of them. We prosecute tax preparers when we catch them doing that. But, again, over half the returns in EITC are prepared by preparers; 28 million of those returns come in and our ability independently to deal with them is limited.

So the third piece of the triangle is we would like to have authority to provide a requirement of minimum competence by tax preparers, basically that they should take continuing education the way lawyers and CPAs do. At this point, anybody can set up shop down the street in a community center and start preparing tax returns whether they know anything about the Tax Code or not. The ones that concern us are the ones in immigrant communities and low-income communities who hang out a shingle and say, Come with me, I will get you a bigger refund than anybody else. And that, obviously, can't be legal.

Mr. QUIGLEY. Thank you, sir.

Mr. CRENSHAW. Thank you.

Mr. Rigell.

TECHNOLOGY AND PRODUCTIVITY

Mr. RIGELL. Thank you, Mr. Chairman.

And, Commissioner, thank you for being here. I was struck by this cover of *The Economist*, where it refers to this "Planet of the Phones." And, by 2020, 80 percent of adults will have a supercomputer in their pocket. I think we are all in agreement that the rate of change in technology is just stunning. It truly is exponential. I think it does stand in contrast to the testimony that you provide, the written testimony.

By the way, I sincerely appreciate your service to our country. That said, I really am troubled by what I read in here because it is just a litany of woes of funding. And what I think the disconnect that I see is the recognition that technology has allowed for such sharp increases in productivity. When we reference that inflation adjusted, we are going back to 1998 levels, yet we have a 23-percent increase in the amount of activity or returns filed, well, at first this sounds compelling. And you would have to pause at that moment.

But when you take into account the incredible increase in technology, seems to me that a 23-percent increase in the number of returns, for example, could easily be handled. And if a leader doesn't believe that change can take effect and be moved throughout an organization, it won't happen.

Mr. KOSKINEN. I agree.

Mr. RIGELL. And I question—and I think based on what I have read and what I am seeing here—your real belief that you can accomplish the IRS’ essential mission within the budgetary constraints that we have as a country and the funding that you have now.

Mr. KOSKINEN. If you read, as I am sure you already have, the last part of the testimony, it sketches out—particularly in IT—the changes that we need to make, as I have talked about here. We need to—in fact, as our IT head, who is terrific, says, “We don’t need to be an early enabler; we just have to be a fast follower.” In other words, we do not need to be at the cutting edge. But we need to get, as I call it, into the 21st century and not still be back in the 20th century.

So a big chunk of the IT expenditures, which are a big chunk of the budget, would be and are devoted toward, as I said, building toward improving the taxpayer experience. In fact, as I noted, if we hadn’t made the improvements we already have with sort of a clunky system of, you know, 150 million people asking where their refund is, even if some of those are obviously punching the app more than once, even if it is only 5 million or 10 million or 15 million people, they used to call us. They used to call to say, “Where is my refund? How soon can I get it?” I couldn’t agree with you more. We need to get more into that area. But you can’t get there for free. You have to actually make the investments to go there.

Now, this committee has been very supportive of the business system modernization part of our budget, and it has made great progress. What we are suggesting is that we could, with an increase in information technology, get to a future state, where as I said, I don’t think we need to get back to 100,000 employees. But we can’t end up with the old technology system and—

Mr. RIGELL. We will try to help you get there. And I try not to approach every hearing like this in just a flatout confrontational adversarial way. My father retired from NASA, and I never saw someone work any harder than he did. So I don’t start out with some disparaging comments about a Federal employee.

LEADERSHIP

Now, the agency has got real issues. And I would suggest to you that, as I read your written testimony, and I certainly read about the specific IT improvements that you want to make, I just was left troubled—and I have shared this with you—that how you see the organization and your ability to transform it. A company that is in rough shape, like Ford Motor Company was so many years ago, Alan Mulally, I mean, came in there and just did what others didn’t think could be done. I want you to be that person, but you need to be constructively disruptive in how you approach the leadership and really push the people in a good sense to let them know that they can do more with less. And this is needed, and this is expected by the American taxpayer.

Thank you for your testimony today.

Mr. KOSKINEN. I appreciate that. If you look back in my background, I spent 20 years in the private sector managing some of the largest bankruptcies and turnarounds in the history of the

country. And I firmly believe that it all starts at the top. You need to, in fact, affirmatively lead an organization.

I would just conclude by saying, as I have said and I mean it, of all the organizations I have dealt with, this is the best workforce. It is a dedicated group of people who take the mission seriously, particularly the mission of helping taxpayers. But you are right. We can't—and I feel strongly of that—we can't keep doing business in the old way. So my thoughts about the budget are not, gee, we need to build backwards. My thought about the budget is that we need to build forward, and I couldn't agree with you more.

Mr. RIGELL. Thank you. And I thank the Chairman for letting us roll over a minute there.

Mr. CRENSHAW. Thank you.

Mr. Bishop is recognized.

INFORMATION TECHNOLOGY SECURITY

Mr. BISHOP. Thank you very much.

Mr. Commissioner, the IRS, which is the world's largest financial accounting institution gathers very sensitive and personal data on millions of taxpayers every year. In the past, the security of taxpayer information has been one of the top three management challenges facing the IRS and this has likely worsened with the current funding levels, as you have not been able to fully modernize your IT infrastructure.

Considering the recent high-profile computer security incidents, such as the Sony hack and the Anthem Health Insurance hack last month, I am concerned about any deficiencies that may make the IRS systems vulnerable to unauthorized access or attack on a broad scale, particularly now that the ACA implementation is underway and the State and Federal exchanges are sharing increasingly more personal taxpayer information with the IRS.

What are your priorities for improving the information security measures that the IRS has in place to protect against these kinds of cyber attacks?

Mr. KOSKINEN. It is the highest priority we have. We have been fortunate—I will knock on wood—that we have not had a breach. As I have said, there are over 100 million attacks a year on our system. If you could get a hold of a database, ours is the database that would be attractive and people know it is there. So, even in a time of constrained funding, one of the things I have and our IT people have said, we need to do whatever it takes to protect that database. And, to some extent, you always worry about are you buying belts and suspenders and you try to be efficient and careful with the money.

Well, one area where we are trying to make sure that we are doing everything we can with an antiquated system is to protect taxpayer data because it is a fundamental, basic responsibility we have. And so it is the highest priority, and it is one of the things that does figuratively keep me awake at night. I manage to sleep, but it is a concern I have. And as you see the increasing sophistication of the criminals engaged in all of this, you know that it is an ongoing battle and race.

Mr. BISHOP. Are you sufficiently satisfied that the infrastructure is strong enough to withstand an attack?

Mr. KOSKINEN. I have put it in other testimony that we are driving what I call a Model T. It has got a great GPS system and a sound system and we have built wonderful applications, but it is still a Model T. We are running applications that we were running when John F. Kennedy was president.

So one of the limitations—while we have got security, one of the limitations of our budget is that we can't replace old applications—we have about 50 of those applications. We need to replace them and get rid of them, the old legacy systems. When I was the Year 2000 czar for the country, we were worried about the declining number of Cobalt programmers. Those programs I am talking about were designed in assembly language, which preceded Cobalt programming. So we are running a system that most people don't even know how to program.

Mr. BISHOP. We have got dinosaurs, in other words?

Mr. KOSKINEN. Right. We have IT people that have done a great job. We continue to make progress, and again, with additional support, we are not going backwards. If we had the additional support, particularly for IT, we hope to go forwards effectively. But I would add that—I can assure you—

Mr. BISHOP. So that makes us sleep a little less at night, too—

Mr. KOSKINEN. Well, we are all—

Mr. BISHOP. I mean literally—

Mr. KOSKINEN [continuing]. With our own personal systems—

Mr. BISHOP. Let me change gears—

Mr. KOSKINEN. Sure.

ENGLISH AS A SECOND LANGUAGE

Mr. BISHOP [continuing]. Just a moment. My time is about to run out.

Most taxpayers and even many tax professionals would agree that the Tax Code is complex and confusing enough in English. While the Taxpayer Advocate Service provides services to individuals who speak English as a second language, what programs or mechanisms do you have in place to assist taxpayers who speak English as a second language and how effective are those programs? What measures do you have in place to protect taxpayers with limited English proficiency from becoming victims of identity theft, tax scams, and impersonation?

Mr. KOSKINEN. It is a challenge. Obviously, in this country, it is more than English as a second language with one language. There are, in some schools in the Washington area, 30 to 35 languages spoken. We translate as much of our Web site we can, not only into Spanish but into other languages. We have employees who are fluent. There are somewhat esoteric languages where it is difficult and people need to have translators to be able to work through it.

We are concerned that a lot of people speaking another language are recent immigrants, are low-income people, and they are the ones most subject to attack by either criminal tax preparers or tax scammers because they are the ones that somebody calls them on the phone and says it is the IRS. They actually get very nervous and are the ones most susceptible to being taken advantage of. So we do our best across the board to publicize that, to warn taxpayers at all levels about phishing expeditions: how you can be

taken advantage of; what you ought to be careful about when some tax preparer says, "Sign a blank form and I will file it for you" or "I will get you a bigger refund that you know you are entitled to."

And so we take that responsibility seriously to reach out to taxpayers to try to make sure that they know what their responsibilities are but also that they get as much help as they can to know what how to file effectively and how to be protected.

Mr. BISHOP. Thank you, sir.

Mr. CRENSHAW. Thank you.

Mr. Graves.

FRAUDULENT REFUNDS

Mr. GRAVES. Thank you, Mr. Chairman.

Commissioner, good to see you. I wanted to follow up on Mr. Quigley's point about fraud and identity theft. You know, it strikes me that the number he cited was \$5.8 billion—

Mr. KOSKINEN. Correct.

Mr. GRAVES [continuing]. Which is more than half of your entire agency's budget. And we use the term "fraud," in reference to identity theft. But, in effect, it is your agency sending refunds to people in that amount. Is that not correct? It is \$5.8—

Mr. KOSKINEN. Right. It is the \$5.8, in effect, illegal—

Mr. GRAVES [continuing]. Billion dollars of taxpayers' money being sent to people whom do not deserve it and who are criminals?

Mr. KOSKINEN. Exactly.

Mr. GRAVES. And it is permissive in some aspect through this agency and enabled through this agency.

Mr. KOSKINEN. Well, it is—that is right. We process—we will process this year 150 million tax returns. We have already processed about 75 million, and 60 million of them got refunds. And that's one of the reasons I have said we need to get W-2s earlier. When I got to this agency, I assumed the IRS got the W-2s at the same time we all get them as workers and taxpayers. We get them in March. So we are actually able to match, but it is pay and chase in that regard. We have very sophisticated filters.

Mr. GRAVES. And that was my follow up. So what is the percentage of these tax payments or refunds that you are issuing that occur during that window in which one can earliest file and when you receive the corresponding documents that verify the income and the identity of the person?

Mr. KOSKINEN. Well, as I have said, we have already—we haven't gotten the W-2s yet, and we have already sent out 60 million refunds. You know close to 80 percent of people get a refund with their return.

Mr. GRAVES. And so, within just a few days of one filing online, they could have this fraudulent payment or refund from the IRS within a few days deposited onto a debit card that they might have purchased at a convenience store without any match of identity whatsoever, and there is no policy that prevents that?

Mr. KOSKINEN. You have got it right. The policy that—the only thing that prevents it, the way we stop \$20 billion of that is with a sophisticated set of filters that look at the return coming in. And each year we get better at figuring out which ones look like they

are fraudulent. We hold them. We write taxpayers. We ask for authentication. We have fixed part of the problem.

In the old days when we sent out checks, you know, you would get your refund in the summer and well after the filing season. By being more efficient, by getting almost 90 percent of people to file electronically, we tell people we will get you a refund within 21 days. And so for the vast majority of people, that is terrific. They get their refund in January or February.

One suggestion we are looking at is, if we can't get the W-2s earlier to do the matching, the question is, can we actually go to a situation where we don't give people refunds? The problem with holding 60 million, for instance, refunds until we get the W-2s is we would be trying to process them, by the time you get done with 100 million returns, in about a 2-week period and even our system can't do that. So—

Mr. GRAVES. It strikes me rather odd—I imagine, also the committee and the American people—that the Internal Revenue Service would, without verification, send out a refund just because they received a submission online through an online portal without verification whatsoever of the person's identity and deposit that money to an unverified account without being able to track it to an individual. But that is what happens, and it amounts to \$5.8 billion just in 1 year.

Mr. KOSKINEN. Right. And \$20 billion didn't go out because the filters were able to determine that those refunds were fraudulent and, in fact, shouldn't go out. That is one of the reasons I have pushed—and we have gotten a lot of support but not final legislation—the need to get those W-2s in January, not in March. We need to be able to get that—

Mr. GRAVES. So that is not—

Mr. KOSKINEN [continuing]. 1099s earlier.

Mr. GRAVES. That is not something that is handled through the agency, but that is actually law.

Mr. KOSKINEN. That is law.

Mr. GRAVES. And there is nothing that your agency can do. So it is just a wide open field during that period of time.

If I could add just a couple more questions to this. So you would accept a request for refund in this same time period from an overseas IP address as well?

Mr. KOSKINEN. Right. We have filters, without getting into details. Depending where the return comes from, we now can identify devices they are coming from. We have limited the number of refunds that can go to a card so everybody doesn't get totally treated the same way. So if you are filing for a refund from someplace else, we take that into consideration.

Mr. GRAVES. Is there a limit to the number of returns that can be requested through a single IP address?

Mr. KOSKINEN. Not at this point. It is just a filter that we use. There is a limit. You can only get three refunds to one bank account.

We can't distinguish between debit cards and bank accounts. We are working with the industry to try to figure out if we could. If we knew it was a debit card, it would be another item that we could add to our filters. And the industry is starting to cooperate

with us. And we hope that, at some point, we will be able to use that as an indicator. Right now we have no idea. The numbers are the same. It could be a bank account. It could be a debit card.

Mr. GRAVES. Well, and I wouldn't at all put the blame on the industry. I don't believe it is the industry. I believe that it is an agency that, without verification, sends out refunds very rapidly, very quickly, to folks who are criminals, and have no verification whatsoever and deposit that money knowing that it will never get it back. And, all the same, knowing that \$5.8 billion could go to defense. It could go to so many other needs within our country right now. It could go to lowering taxes on hard-working Americans, but instead criminals all across the country, if not across the world, are receiving these tax refunds.

And I will just make one other note. I heard you bring up a minute ago tax preparers as one of the issues. I don't believe that to be so. I know tax preparers from a professional perspective are very respected in their community. They are registered oftentimes with the IRS and other associations and do a great job. It is the criminals who are the problem, not the tax preparers who, from a professional perspective, work very hard and have a small business and are just trying to provide a portal for individuals to file their taxes lawfully in a very complicated tax system.

Mr. KOSKINEN. If I could explain. I think that is exactly right. There are 700,000 registered return preparers who have PTINs and can file returns with us. Over 350,000 are accountants, CPAs, and enrolled agents who clearly do a great job. A big chunk of those 400,000 who don't have any certifications or qualifications are educated and mean well and do a good job. But there is a chunk of them at the edge, that unfortunately is larger than anybody would like, who either have no knowledge about the Tax Code at all and are simply winging it or are consciously trying to cheat. And those are the people we, for some time now, do not have the ability to regulate. We spend a lot of time monitoring them. We have thrown some in jail. We look for schemes. But, again, it is kind of a pay and chase. And that is the only reason I think that taxpayers would be better off if they knew that a return preparer filing their return had some minimum level of tax knowledge.

Mr. GRAVES. Thank you, Mr. Chairman.

Thank you, Mr. Koskinen.

Mr. CRENSHAW. Thank you.

Mr. KOSKINEN. It takes more qualifications to cut your hair than to prepare your taxes.

Mr. CRENSHAW. Thank you.

Mr. Yoder.

Mr. YODER. Thank you, Mr. Chairman.

Commissioner, welcome back to the committee. Thanks for your testimony today. I appreciate your testimony and your stated efforts to try to run the department more efficiently and try to clean up some of the challenges culturally that have occurred within the IRS in recent years. But I would think, you would agree, the IRS is still a troubled agency. And things that trouble me are continued abuse of the Constitutional rights of Americans.

You know, it has been often said that the power to tax is the power to destroy. And I believe that the continued efforts to destroy

the Constitutional rights of Americans is still a problem that plagues your agency. In the past, we have dealt with the reading of emails of Americans against their Fourth Amendment rights. I believe that is a practice the IRS has stopped. We have discussed this before.

But I still have concerns regarding groups who have applications before the IRS being delayed because of their ideological beliefs, therefore, in violation of their First Amendment rights. We have headline after headline about the IRS seizing accounts and assets of Americans with no crime required, with no due process, with no right to have their issues heard, their assets just seized.

501(C)(4) BACKLOG AND ASSET SEIZURES

And so my question would be for you: In terms of the groups that have been delayed, there is an article the other day that is entitled "Death By Delay." And it says there are numerous groups who are still waiting multiple years or long lengths of time to have their application reviewed. How many groups are still in the queue, have not had their applications reviewed, or are having their applications denied?

And then, on the issue of seizing assets of Americans without due process, how many assets of the American people are you holding without giving them a chance to speak on their behalf? And what can the IRS do to allow Americans to have greater rights to stand up for themselves before their assets are seized?

Mr. KOSKINEN. With regard to the delays, virtually all of the organizations that had been delayed were cleared. We did an expedited process. If anybody would simply say they weren't going to spend more than 40 percent of their money on politics, they would immediately be cleared. Actually, the (c)(4)s don't need to be cleared. They can actually self-declare and go out and operate.

So the handful—and, I mean, it is literally a handful, less than 10 or 12 that are still there, a number of them have chosen litigation, which is their right and they can do it. But it has struck me a little ironic that people have said, "Well, we didn't want to sign the 40 percent. We have a right to litigate." And my sense was, well, you can do that, but it is a little hard to argue that there wasn't a path forward that would get you through it.

But we take it seriously. Back to the issue of whether it is in the budget request language or not, my sense is—and I feel very strongly—people need to feel confident they are going to get treated fairly whoever they are. We should not care and we don't care who they are. And as they apply, one of the things about the regulations is the rules ought to be very clear and easy to understand and people ought to see them as fair so that they are not being, in fact, inhibited in their political activities. But they ought to also feel comfortable that they know what they can do and nobody will question them about it.

With regard to the seizures, we had a long hearing a couple of months ago. First, the IRS never had ability to seize anybody's assets on their own. Any time there was a seizure, whether civil or criminal, it had to go to a U.S. Attorney. A U.S. Attorney then had to make an application to a magistrate or a judge. The judge had to issue an order.

Notwithstanding that, last year, after reviewing it and being concerned about this, we changed the policy. And we have done that in the sense that, if you have structured, which is what it is about, if you have in fact structured your deposit in the bank in a way that it causes you not to have to report or the bank not to report transactions in cash above \$10,000—so if you keep putting in \$8,000 and, in effect, are avoiding the reporting, and that is called structuring—if there is no indication that those funds have come from illegal sources, we will no longer seize them. And we haven't seized them and are not doing that this year at all. And my understanding is Justice is considering that same policy.

Whenever the assets are seized—now they will be seized only if there are indications it is from criminal processes—taxpayers have an immediate right to go to court. They have an immediate right to come to us within 30 days, but they have an immediate right to go to court to contest the issue and, in fact, put the burden of proof on us to demonstrate that, in effect, it is appropriate. So taxpayers are not left on their own, even in the old days. As I say, first, there were restraints on what we could do. We had to get third parties to approve, but in this particular situation now, there is a lot of those that no longer happen. But wherever it happens, taxpayers always have the right—and it has been clear to them—to go to court.

EITC IMPROPER PAYMENTS

Mr. YODER. Commissioner, my time is running short. I wanted to cover one more topic, to follow up on the conversation regarding the earned income tax credit.

And you stated in your testimony today that it is an area where you have made no progress. You admitted that it is an area that needs to be fixed. It is now \$16 billion to \$19 billion in either fraudulent payments or misapplied payments to folks who don't deserve the resources. Your entire budget is \$11 billion. So as we have this debate about where to find resources for the IRS or any other budget, we have \$16 billion to \$19 billion sitting out there in fraudulent or misapplied payments. That is 24 to 29 percent of the entire earned income tax credit amount. So it is certainly something that is a huge problem.

In last year's appropriations budget, we actually directed the IRS to fix this. And we raised an issue that had been raised by tax preparers in my district and across the country directing the IRS to ensure that the same questions are being asked of taxpayers whether or not they are preparing their returns, if they paid a tax preparer, or via do-it-yourself methods, such as paper forms, preparation software, or online preparation tools.

My tax preparers tell me that if we treated individuals who don't use tax preparers the same way and held them to the same standards, that we would be able to eliminate a lot of this waste and fraud. And that has been the directive of this committee. So I do think there are tools at your disposal. We would like to see you utilize those to recover this money.

Mr. KOSKINEN. We are going to pursue that. But in my meeting a year ago when I started with this, it was clear that our biggest problems were the discussions about matching. If we had the W-

2 earlier, we could actually match them to our databases. If we could correct the returns rather than having to audit them, we could make a big dent. We are never going to get it to zero, partially because 30 percent of the population changes every year, people move, get jobs, get pay raises, and they are not eligible anymore. But we certainly need to get improper payment down. My sense is, if we could correct the errors we see, we think there are several million returns where we could make an adjustment without having to do an audit. If we got the W-2s earlier, we could match it.

We are not trying to put anybody out of business—but you know, it doesn't seem to me it is too much to ask that you have to have a minimum amount of knowledge about the complicated Tax Code. If you want to change the Tax Code and simplify it, I think that is a great idea. But, in the meantime, those three things are the help that we need from you all. We are going to continue monitoring preparers. We are going to continue auditing people and checking them. But we are not going to be—without the additional statutory support—we are not going to be able to make the dent in the program that we need to make.

Everybody supports the program because it helps people working and it encourages them to get jobs. But we have got to get this problem under control, or ultimately it is going to kill the program. And so we need your help to do that.

Mr. CRENSHAW. Thank you.

I see that we have been joined by the distinguished Ranking Member of the full committee, Mrs. Lowey. So I would like to recognize her for any questions she might have.

Mrs. LOWEY. Well, I thank the Chairman and I want to apologize to our distinguished Commissioner, but there are several hearings going on.

Mr. KOSKINEN. I could tell that by the cars parked outside.

Mrs. LOWEY. So thank you and welcome.

First of all, thank you so much, as a distinguished graduate of Duke, thank you so—not me. You.

Mr. KOSKINEN. That is right.

Mrs. LOWEY. Thank you so much for taking on this responsibility. We are very, very appreciative and honored.

CUSTOMER SERVICE

Taxpayers need clarity in the Tax Code and responsiveness from the IRS. The fiscal year 2016 request would address the funding shortfalls at the IRS, which are projected to result in as many as 57 percent of phone calls going unanswered in 2015, by raising the level of service on phones to 80 percent. The IRS is at its lowest funding level since fiscal year 2008. And if you take into account inflation, it is now at the fiscal year 1998 level. And, since that time, the number of filers has increased by 23 percent. I should repeat those statistics again. I know the Chair and all of my colleagues would quickly give you all the money that you would like to have so you can do your job effectively.

Nina Olson, the National Taxpayer Advocate, and the Treasury Inspector General for Tax Administration, J. Russell George, both testified before this subcommittee a few weeks ago and mentioned

their concern about the impacts of the cuts to the IRS' ability to function properly. The American people deserve better. We can only be hopeful that this Congress will start to be reasonable and realize that it is harming taxpayers with these ill-considered cuts.

So I have three quick questions: If you could, explain how this budget request will increase services to taxpayers. Number two, 75 percent of this budget request is vested in staffing. How does this level of staff funding impact taxpayer services? Specifically, how will this impact call wait times for taxpayers? And, thirdly, how much revenue are we losing annually due to enforcement cuts? And ultimately, what would this budget request do to facilitate voluntary tax compliance?

Mr. KOSKINEN. As I have said, I agree with the Chairman and the Members of the committee, we need to be efficient with the funds we get. If we obtain these funds, you are exactly right. I know we have made it clear, last year and this year as well: If we had the funds, in the short run, we would be able to, in fact, get a level of service on the phones up to 80 percent. People wouldn't be waiting for half an hour to get an answer from us. The hold times would drop. We used to, in the old days, back at about the 2008 time and before, you used to wait for about 2 minutes to get somebody on the phone. Now the waits are 25 to 30 minutes. And it applies to practitioners as well.

As I have said, the practitioner priority line is an oxymoron these days. It takes you as long to get through there as it does on the normal phone line. So it is clear that on both the revenue-producing side as well as the taxpayer-service side, the cuts at some point begin to become negative and very visible and that is really where we are.

The estimate is that with the 5,000 revenue agents, officers, and criminal investigators we will have lost by the end of this year over the past five years, that that is costing us \$7 billion to \$8 billion a year in audits. But as I said earlier, the concern I have is the combined impact of lowered enforcement and lower taxpayer services. The impact that I am concerned about isn't just about whether we collect more or less. And the Chairman and I will have a discussion about that in terms of what the pipeline looks like. It really is, what is the impact if, as a result of that, you have a decline of 1 percent in compliance and you are suddenly talking about losing \$30 billion?

I understand the constraints. I spent 4 years working in the Senate and 3 years at OMB. So the deficit overall is a real issue. Trying to figure out—as I have told our staff—we have to figure out how to get people to want to give us the money and then work with them to figure out how to get that money. But ultimately my concern is that we are not talking about a short-term issue here. At some point, we are going to put at risk the entire compliance system, and that is not an on/off switch. When people get an idea that, you know, the system isn't working very well and they can take their chances, you can't turn that around overnight.

Mrs. LOWEY. Thank you very much.

And thank you, Mr. Chairman. And I do hope that in a bipartisan way we can respond to your real concern. The cuts are really hurting taxpayers. We are all concerned about the deficit, but we

have to figure out, if we want to collect the revenue and collect the taxes, how do we provide better services? Thank you very much.

And thank you.

Mr. CRENSHAW. Thank you.

Ms. Herrera Beutler.

Ms. HERRERA BEUTLER. Thank you, Mr. Chairman. You know in listening to this—and I apologize, too. I have been in a couple different committee hearings today. 'Tis the season. Everybody is asking for their budgets.

You know, I know that the budget says that you all are advocating for a would-be an increase for your operating expenses. And as the department overseeing the IRS or as the person overseeing it, I completely understand why. I know that you have received pretty steep funding cuts from this Congress—or in the previous Congress. And it is probably getting pretty tough to swallow. I completely understand that.

IMPROPER PAYMENTS AND EFFICIENCIES

It is hard for me to reconcile this to my constituents when, you know, a couple weeks ago, we had the Inspector General, General George, testify in front of the committee and hearing what he highlighted—and even some of it has been referenced today. You know, we talk about the \$5.8 billion. He has cited mismanagement of service software licensing costing \$100 million. He highlighted, you know, more erroneous tax returns. Office space, he said that, you know, the IRS could reduce office space by nearly 100 million square feet, saving us about \$111 million over 5 years without sacrificing performance.

So it is difficult to reconcile, you know, that \$5.8 billion would more than take care of—I believe it is about 10 times what you are requesting in terms of an increase. So it is hard—how do we answer to taxpayers a very rational question: If you wouldn't—just wouldn't send out the money that you had in erroneous errors or if you would make some of these kind of streamlined—the office space, so on and so forth—if you would streamline some of the recommendations that another agency is already taken care of, then you would have that part—then you would have that money back. I mean, we could—we could even agree to probably let you keep the money if you went back and collected it or kept it. Do you know what I mean?

Mr. KOSKINEN. I was going to say, unfortunately, as we get better at collecting money or tracking down fraudsters, we don't get to keep it. And that is probably right. We shouldn't be—

Ms. HERRERA BEUTLER. I bet you we could make you a deal.

What do you think, Mr. Chairman?

Mr. KOSKINEN. That is right. Well, we do collect a lot of money that way.

The point I would make is I spent actually 3 years chairing the Interagency Council of Inspectors General. I am a great supporter and believer in the internal audit function and the IG function.

The IG has a series of reports and does a great job in pointing out where we could be more efficient. GAO does the same thing. The Taxpayer Advocate. We have a lot of people giving us suggestions. We take them all seriously as we go forward.

All three—the Inspector General, GAO, and the Taxpayer Advocate—have said, notwithstanding all of that, the budget of the IRS is substantially underfunded and puts taxpayers and the system at risk. So they have all said there are things we could do, and we are continuing to try to do them. Office space is one. We have cut 1.8 million square feet. We have more people telecommuting. Telecommuting turns out to work very well and efficiently, and we need to do more of it.

We have a standing rule right now, if a lease comes up, it doesn't get renewed automatically. We take a look at, and ask, is there a way not to renew it. We just, in midtown Manhattan, saved \$4.5 million a year by not exercising a lease and moving people into other space.

So I think you are exactly right. And I agree with the Chairman. We need to be as efficient as we can. And when somebody comes up with a suggestion, rather than being defensive, my view is, if it is a good idea, we just ought to take it. And the fact that we didn't do it last year or 2 years ago shouldn't mean we shouldn't do it going forward.

So I read the IG reports regularly. I read our responses to make sure that we are not ducking out on those. Some of the issues have been about hiring employees, who the IG noted, had prior performance records. I told our people, that is exactly right. We shouldn't do that, and we are actually going to change that.

But, ultimately, as I said, we save about \$200 million a year now that we didn't used to save because of space and contractors and others. And if we could move that to \$300 million, I would be delighted. But the gap is bigger than all of those efficiencies. But my point is—

Ms. HERRERA BEUTLER. Well, wait. It is not, though, I mean, if you look at the dollar number.

Mr. KOSKINEN. Well, I can't take the \$5.8 billion and if I get it down to \$2 billion, take some portion of that—

Ms. HERRERA BEUTLER. Hey, I would advocate for you on this side.

Mr. KOSKINEN. I need to talk with you more about this.

Ms. HERRERA BEUTLER. You get to keep what you save. I meant it. I am working with the Forest Service on a similar idea.

S CORPORATIONS

Let me switch gears. We hear a lot about tax reform and loopholes, particularly from the administration. That has been kind of a hallmark of talking about making the big guys pay their fair share and not taking it out on the small guys. The IRS IG reported in 2013 as much as \$2.3 billion was erroneously given to corporations in carry-forward credits. However, the IRS does not plan to follow recommendations to address that. At the same time, the IRS is, to quote Inspector George, "Dedicating significant resources towards addressing what it believes is the most significant risk to compliance, the use of flow-through entities, such as partnerships," unquote. Flow-through entities or S Corps—and more often not, they are small family-owned businesses. Meanwhile some of the biggest users of the carry-forward credit are large, publically owned, publically traded corporations. So what it looks like—cor-

rect me if I am wrong—is that the IRS, by extension the Treasury Department, is ignoring \$2.3 billion per year in improper awards to some of the biggest corporations on the planet on top of the billions they legally save through existing loopholes so that the government can, on the other hand, dedicate significant resources to auditing those small, family-owned businesses. Help me understand that.

Mr. KOSKINEN. Well, first of all, we try not to reveal too much regarding audit selection. But the bigger you are, the more likely you are going to be audited. Major corporations are under constant regular audit. And so we have an audit plan, and we look at what the impact is. If we only wanted to collect money, we would simply audit the biggest corporations and the most wealthy individuals. But that would mean—because the preparers are pretty smart, everybody would understand, if you are below this threshold, you can do whatever you want because they are not auditing you. So that is why we audit low-income people and middle income people as well.

So, first of all, we don't ignore corporations. Our pass-through issue is a subject to have a long hearing about. Again, we need authority.—The TEFRA rules that were great 30 years ago don't apply now because the problem we have is not small partnerships. It is the partnerships with over \$10 million in assets and 100 partners. We have 5,000 that have over 1,000 partners. Some of the partners are partnerships. And what it takes to get through all that to conduct an audit means that most of them don't get audited. It is a big problem. And, again, there is a legislative fix that is a Treasury Department proposal that we hope will get enacted that would allow us to balance that out.

Because I agree with you, we need to be fair across the board. No one should feel that they are out from under and that they are never going to hear from us. On the other hand, as I said earlier, if you hear from us, you should hear from us because of something in your return. You shouldn't hear from us—you shouldn't have to worry that you went to some meeting, you wrote an op-ed, you belong to a particular party, that is why you are hearing from us.

Even with our constrained resources, we will do over a million individual audits this year. And my concern is everybody should understand those are selected automatically because of something in the return. I don't want anybody feeling that somehow they were picked on because of who they are or what they do outside of filing their tax returns.

So your concerns are appropriate, as I say. On the partnership passthroughs, it is a fascinating problem. More and more organizations are forming as passthroughs rather than as C corporations. So the volume of business being done at all levels in partnerships, Master Limited Partnerships, et cetera, is growing. And it is, at this point, growing beyond our ability to effectively keep track of it.

Ms. HERRERA BEUTLER. I yield back.

Mr. CRENSHAW. Thank you. I think we have a little time for some additional questions.

I don't know, Mr. Serrano, do you have additional questions? Please.

Mr. SERRANO. Thank you. Let me first comment on something you said before because you were pretty fast with the—quick with the microphone.

The reason that the IRS collected more taxes is because more people were filing on their own because the economy is doing better and because we have more taxpayers every day. If the majority party, as I think it will, does something about immigration reform before 2016 election, there will still be even more people paying taxes. And the question is, will they have the resources to be ready to deal with it? And so it is not that we cut their budget and they collected more money and, therefore, we need to keep cutting their budget. It is that more people are filing and many more will file, if we ever do immigration reform, which I have got a little hint that something will happen before the Presidential election on immigration reform. Just a little hint.

TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION

And since this subject was brought up, I wasn't going to comment on it. I do have to address it. The 501(c)(4) issue is 2 years old. Despite the numerous personnel changes made at the IRS, new leadership being brought in, and intense scrutiny from numerous investigations that themselves have caused the taxpayers millions of dollars, the majority party acts as if every day is Groundhog Day anytime the IRS is brought up. Furthermore, they exaggerate the number of employees involved. They blame everyone at the IRS for the mistakes of a very small number of individuals. The employees who are there now are the ones we are tasking with turning things around. You would think we would want to help them so they can be successful rather than mindlessly attacking them.

And let me remind this committee that if you look at the comments I have made, which we keep records of, I was as outraged as anyone else that something like this could have happened, did happen, or was happening, you know. I mean, I was not making excuses.

J. Russell George, the IG for tax administration, who looked into the 501(c)(4) issue, indicated that you have been very open with him and that you have an open line of communications with him. We are very pleased to hear this. Please tell us about the changes in the Exempt Organizations Unit and update us on the cost incurred to taxpayers due to all of the investigations.

Mr. KOSKINEN. Well, as you note, if you go back to who was around at that time and you start at the top, the entire chain of command is gone. So we have new people, the Commissioner at the Tax Exempt and Government Entities Division who is running that Division, the Deputy Commissioner for Services and Enforcement and the Commissioner. And you make a good point, the entire Exempt Organization Division of the IRS is about 900 people. Even with the cuts, we have 87,000 people total at IRS.

So again generalizing from a management problem that shouldn't have happened and it was a mistake and it has created concerns that I share, but saying that that exemplifies what the other 86,000 employees are doing obviously doesn't help. But we are dedicated to making sure that the situation doesn't occur again. We do work very closely with the Inspector General. As I said, I

view internal audits and oversight and ideas from third parties as important. We are trying to build a culture in the IRS where every employee views themselves as a risk manager and knows my view that bad news is good news. The only problems we can't fix are the ones we don't know about. And as I said at my confirmation hearing, it would be nice to say we will never have a problem, but obviously, it is a complicated code. We deal with almost every American, and we have 87,000 employees.

So my commitment is, if there is a problem, we will find it quickly, we will fix it quickly, and we will be transparent about it. And part of the problem in the whole (c)(4) issue has been, you know, some lack of transparency. And I don't think the system can survive with that. So my view on all of these questions, whether it is seizures or hiring employees with problems, is we need to deal with it, if the facts are there. We shouldn't be arguing about the facts. We should be deciding what are we going to do to fix that problem. And I want people to be comfortable that when a problems arises, we are going to take it seriously, we are going to fix it, and we will be transparent about it.

Mr. SERRANO. Thank you.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

Mr. Graves.

QUARTERLY WAGE RETURN

Mr. GRAVES. Thank you, Mr. Chairman.

I just had a quick follow up, if I could, on the topic we were discussing a minute ago about the tax refunds being sent to criminals.

Just from a reconciliation perspective—It has been awhile since I have been in the private sector and thought through all the reports that were filed. But, if I recall, there is a quarterly wage report that is required to be filed—maybe it is the 941—and it is required each quarter, 30 days after the end of a quarter, which indicates the person's Social Security number, his or her name, and wages. Taxes associated with that individual would have been deposited within a banking institution and then forwarded on to the Internal Revenue Service. Is that not correct?

Mr. KOSKINEN. We get the quarterly returns. I am not sure whether we get all that subset detail. In fact, one of our problems is to try to make sure we get the quarterly returns.

[The information follows:]

The Form 941 is a quarterly return that transmits summary data of wages paid to employees and does not include a listing of the individual employee's information (name, Social Security Number, wages, taxes withheld, etc.). Therefore, Form 941 cannot be used as a substitute for the Form W-2.

Mr. GRAVES. It seems like the information from quarterly returns is data. Those are data points which could reconcile, at least in the interim until you get the final W-2, which is required to be filed by the end of March 31st as you indicated—that might provide a little bit of data there to work with. And if I am not mistaken, the fourth quarter 941 was required to be filed by the end of January, which should conclude all four quarters of the previous year. It should be on file with the Internal Revenue Service, I would suspect.

TAX SIMPLIFICATION

And then just one other comment. If we could just provide a little clarity, you have spoken a few times today saying that your preference would be that there is minimal training for individual preparers, or professional preparers who file returns on behalf of individuals. And that might be your opinion.

And my opinion of that perspective is that when you make that determination, then, maybe the Tax Code is just a little too complicated. And that if it is required of a professional to have minimal training, how can we expect the average, hard-working American to fill out these tax returns as well? But I can tell you this, without minimal training, the criminals have got it figured out, and they are the ones who are filing these fraudulent returns and the ones that are receiving these payments from taxpayers—from the IRS.

Mr. KOSKINEN. I always preface my comments by saying tax policy is the domain of the Treasury Department, the White House, and the Congress. We are in the tax administration business.

Having said that, I am a great believer in tax simplification. I agree with you, when all of us are using preparers to file our returns because we are not confident we can do it ourselves correctly, the Code is too complex. I thought Congressman Camp was right that the Tax Code is bigger than the Bible with none of the good news. I have told him for a year, I am going to give him credit, and then I am stealing that quote.

But I think it is totally right, and I have nothing against tax preparers. They provide a great service. But some taxpayers ought to be able to have an idea that the Code is simple enough that you can not spend—the amount of time—it has been estimated we spend 6 billion hours of time filling out our tax returns. If you think of the intellectual capital, you have to be smart to be a tax accountant, tax preparer, or tax lawyer. If you think of all the intellectual capital spent just trying to figure out what the right amount to pay is, and if we put that intellectual capital to some other use, it would be a great thing for the country. So whatever we can do to help tax simplification, we are delighted to do that.

Mr. GRAVES. Thank you.

Mr. Chairman, how about that? Ending on common ground.

What do you think, Mr. Serrano?

Mr. SERRANO. Are you done?

Mr. GRAVES. Yes, sir. Absolutely. Yes, sir.

TAX PREPARERS

Mr. SERRANO. I understand your point about the criminals, and we all agree on that. But some of the criminals are tax preparers. And if you go into certain neighborhoods, you will see blasted on the window, "Come in here, and we will get you the best break." You know, that is not what they are supposed to advertise. They are supposed to advertise, "We will file your return." And so not everybody goes in saying to a tax preparer in a storefront operation, "I want to cheat on my taxes." But, in many cases, you have someone who says, "Come in and we will get you the better deal" and the better deal is the one that he thinks should send some people to—at least to be scrutinized by the authorities.

Mr. GRAVES. And I understand the gentleman's point. Reclaiming my time.

My point is that those individuals clearly have above minimal training in order to figure out how to evade the tax system. My point is, for all the law-abiding tax preparers, professionals out there that work hard everyday and have a small business and are trying to help folks, I think they are doing it the right way, and their minimal training shouldn't be a requirement of the Federal Government. And if it is required, maybe the Tax Code is just a little too complicated.

Mr. SERRANO. And they are the largest group, the fair-minded.

Mr. GRAVES. Right.

Mr. SERRANO. The clean guys and ladies are the largest group. But there is still that small group that creates a problem for everyone.

Mr. GRAVES. Thank you.

Thank you, Mr. Chairman.

Mr. CRENSHAW. Ms. Herrera Beutler, do you have any more questions?

MATCHING INFORMATION

Let me just—a couple of quick questions before we go. And we talked a lot about fraud, the \$5.8 billion. And you mentioned that the administration wants to move up the W-2s. And then you said maybe if we waited later on, after we have all of the information, then process those returns, you would have more information and maybe there would be less fraud. But, on one hand, I have always—I have thought about that. The taxpayers might not like that. They love getting their refunds early.

Mr. KOSKINEN. We would have 60 million who already got their refunds calling us and saying, whose idea was that?

Mr. CRENSHAW. But is that something you would really think about, now?

Mr. KOSKINEN. Yeah.

Mr. CRENSHAW. You mentioned maybe one of the problems is that all of a sudden you will have to process all of those at the end. But I imagine you staff up when you are, you know, processing now. If you staffed up a little bit later. But, obviously, there is a concern of the taxpayers, I file my tax returns, I want to get my refund.

Mr. KOSKINEN. Right.

Mr. CRENSHAW. But what is the biggest objection to that, to say—rather than you call it chasing a file, but say you file your tax return and then maybe sometime 3 months after that, when all this information has come in and you can even do a better job of weeding out the fraud, what prevents you from suggesting that?

Mr. KOSKINEN. We have actually—because I have said we need to start from scratch. So we have looked at that in terms of what the impact is.

Part of the problem is, it is not just a question of more IRS employees because the filings really are electronic. If we get 100 million—you know, it is about 100 million to 110 million out of 150 million are going to get refunds. If we put them all into that last couple of weeks, the system simply won't be able to—

Mr. CRENSHAW. Well, do they have to be in the last couple of weeks?

Mr. KOSKINEN. Well, because if we don't get the information until the end of March and filing season deadline is April 15, we don't have a large window of time. But we are—

Mr. CRENSHAW. I mean—and this is, I would say, after you file returns in April, right, and right now if you file a return early, you can get a refund pretty quick. But what if it were, you file your return by April 15, but you are not going to get a refund until, let's say, 3 months later because you got more time to do all of the due diligence.

Mr. KOSKINEN. We actually have looked at that and are considering, is there a way to, in fact, delay refunds, and what is the impact on taxpayers? Part of what happens is, of the 80 percent getting refunds, a group of them who are middle- and upper-income people, do it primarily because it is a pain in the neck to write a check in April and you would rather just get a refund.

A larger group of people getting that refund, it is the biggest check they get all year. And they are acclimated now, at least used to, in January and February to have it. They are paying for rent or other expenses. Now, even having said that, if you got everybody acclimated, then, instead of being February, it is April or it is May, you have a tough year and then you would have everybody—every 12-month cycle would go that way. And we have actually looked at—it is somewhat draconian for people who expect that. We have to pay interest if we haven't given you your refund within 45 days of April 15th if you file a timely return. But even that, at today's interest rate, isn't very much.

So we have continued to look at, are there ways to modulate or adjust. Recently, this week, there was a survey in the *Wall Street Journal* that they reported on and it said, well, you know, the majority of taxpayers say they would be happy to wait a while for their refund if that meant that they were less likely to be subject to identity theft.

So it is part of this package of, okay, how do we deal with this, again, recognizing that we are fighting a battle with very sophisticated criminals with very high-tech equipment? And so, you know, delaying refunds is something that we are going to have to look at.

Even if we get the W-2s by the end of January, it means, by definition, you are not going to get them, your refunds—you know, filing season usually starts January 20th. So there is going to be a delay built in, even if we had the information returns earlier. The advantage of getting the W-2s earlier is we could spread that delay out over a period of time, which would be much more manageable.

Mr. CRENSHAW. And it might even help with the earned income tax credit. If you had delayed refunds, whatever, it might give you a little more time to—

Mr. KOSKINEN. Yes.

Mr. CRENSHAW [continuing]. Deal with that because that is, like, \$6 billion and \$19 billion and somehow if you could—

Mr. KOSKINEN. Like half.

Mr. CRENSHAW. You know, part of that, it might be worth taxpayers saying, well, we will wait a little bit.

Mr. KOSKINEN. Yeah.

Mr. CRENSHAW. Maybe their taxes will go down if we—if we collected all those.

FILING WITH INCORRECT INFORMATION

The last question real quick, and this is just—this is—and I am just curious about this. When I read about the 50,000 folks that filed tax returns based on the incorrect information they got, I think there were 750,000 people that got that incorrect information. The 50,000 that filed, you all decided, well, if they owed additional taxes or whatever, you are just going to kind of let that go.

I just wonder, is that going to be a problem? What about the next batch? I mean, all the people that got incorrect information, the next 700,000 that file, is there any kind of due process issue with them? Or how do you decide we are just going to—they got wrong information, they filed a return, maybe they got a refund, maybe they are going to owe back taxes? On the other hand, maybe they will—you know, it might be a wash. But how do you make that decision?

Mr. KOSKINEN. Well, it is a policy decision that actually is made by the Treasury Department in terms of where it goes. Obviously, we have had other programs where you have a transition year. In fact, we have even talked with the States, you know, if you get your program not quite right, you can have a transition time. So the idea for the 50,000 has been made clear, this is a one-time this-year-only issue.

But the point you raise is a good one. If there are other corrections in 1095-As, you know, what do you do with that? You can make a policy decision, but one problem is the administration of it in terms of, you know, you can complicate our processing issue enough that you actually put it at some risk. But those issues are, fortunately, affecting a relatively small amount, about 50,000, out of the 75 million who have filed. The other 750,000—there were about 800 to start with—have been advised and they are apparently waiting. They are going to get their corrected form—just like you get a corrected W-2, and they will file their return with the correction. But it is clearly possible there are going to be other errors.

We have encouraged taxpayers to look at their 1095-A and make sure that it corresponds with their experience. And some of them will, obviously, at some point, find an issue. I think the Treasury concern was this was a, you know, not a mistake the taxpayers made. It was a mistake by the government. And so, you know, if you have already filed and the differential amounts generally are relatively small, we shouldn't give taxpayers that burden.

But I think the point is a good one that if there are going to be other, you know, 2,000 people here and 1,000 people there, in some sense, our view is that we need to administer the Tax Code in an orderly way. And I think Treasury is sensitive to that.

Mr. CRENSHAW. Well, thank you. And let me—any other questions?

Mr. SERRANO. Just one further comment on the subject I mentioned before, just to show you the need to look at this agency as a department that needs resources in the next few years. If we get immigration reform—and this is something my colleague and I

have discussed at times—it is pretty much bipartisan belief that you will pay a fine—who they will pay that fine to, the IRS or the Treasury, but that has to be processed. But then a process will be worked out to pay back taxes. It certainly is to them, and that will be huge numbers of people. Then you have people who have been working with a TID number, which is totally proper. And you have people who have been working with somebody else's Social Security number. You know, all of that will have to be sorted out. So when we look at this agency, we don't look at an agency that will have less work to do in the next generation but rather much more work to do.

Mr. CRENSHAW. Unless we simplify the Tax Code and then—

Mr. KOSKINEN. That would help. That would help.

I would note, just a response to that, as I have talked to our employees about it, one of the ironies but good signs is, when there is a program and there is an attempt to do something, a lot of times people give it to the IRS because the assumption is the IRS will do it. And it has a history—it has got a great workforce. It has really got, as I said, a dedication to the mission that is reassuring and amazing to watch. But it hasn't escaped me over time, including the ABLE Act and the Professional Employer Organization requirement, that people are comfortable and confident—if you give us a responsibility, we will do whatever it takes to try to get it done, even in constrained resources.

And I think that is important for the public to remember that, with all the appropriate discussions about are we doing it right, are we being efficient, there is a confidence that if you give us a responsibility, we will take it seriously. And we won't make a judgment; such as do we like this or don't like it? If you say to do it, we will do it. And I think it is important for taxpayers to sense that degree of confidence in the agency because ultimately it goes back to my real concern, as I say, people have to be comfortable and confident in the system if the compliance rate is going to continue and the process will be continued to be viewed as fair.

Mr. CRENSHAW. Well, thank you. And let's just end on a positive note. Let me thank the Commissioner. He has been working with a group called the Free File Alliance.

Mr. KOSKINEN. Right.

Mr. CRENSHAW. And they just entered into an agreement, a 5-year agreement, that about 70 percent of all the taxpayers are going to have access to filing their taxes free. That is something he has been working on.

And I want to congratulate you for that. Thank you for that. And thank you for being here today.

And we will all adjourn the meeting right now.

Mr. KOSKINEN. Thank you.

Financial Services and General Government Subcommittee
Hearing on the Internal Revenue Service
for Commissioner John A. Koskinen

Questions for the Record Submitted by Chairman Ander Crenshaw

Employee Productivity

Question: What is IRS doing to increase employee productivity?

Response: The IRS is re-engineering and streamlining business processes and realigning work to not only improve employee productivity but also enhance the taxpayer's experience. For example, all identity theft case work has been realigned under one operating division – Wage and Investment. The realignment coupled with streamlining the process will result in efficiencies. Another example is the Lean Six Sigma effort completed in the Exempt Organizations determination work. This resulted in the development of Form 1023-EZ that small organizations applying for exempt status can use. This has reduced the time to process the Form 1023-EZ determination applications and reduced the amount of information that the organization has to file with the form. The IRS continually strives to improve processes or work flow to gain productivity. Improving tools and resources available to employees would also be helpful, but the IRS budget does not allow us to do all we would like in this area. Increases in IRS productivity that are being realized through re-engineering and streamlining business processes are being offset due to old and outdated technology equipment. For example, last fiscal year over 600,000 hours of Revenue Officer time was lost due to laptops that experienced significant problems.

Question: Has IRS eliminated as much manual data entry and as many manual workarounds as possible from its business processes?

Response: Electronic filing of returns eliminates the need for manual data entry for those returns. As of April 24, 2015, 89% of individual income tax returns were filed electronically. With this increase in electronic filing, the IRS has realized savings in multiple areas, including reducing the number of sites processing incoming paper returns. In addition, Congress provided some incentives to taxpayers filing information returns by extending the due date for returns submitted electronically, which increased the number of electronically filed submissions. The IRS currently receives approximately 97.6 % of all information returns electronically (this level only includes information returns (does not include any W-2s) and is FY15 cumulative, through 5/7/15). Information returns are filed by any person engaged in a trade or business, including a corporation, partnership, individual, estate, and trust, who makes reportable transactions during the calendar year to report those transactions to the IRS. Examples include the Form 1099 series and the Form 1098 series.

Congress can help us further reduce the costs of manual data entry by enacting the Administration's legislative proposal "Enhance Electronic Filing of Returns" which is included

in the Treasury Department's FY2016 General Explanations of the Administration's Fiscal Year 2016 Revenue Proposals (<http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf>). This proposal would require all corporations and partnerships with \$10 million or more in assets to file electronically, as well as corporations with more than 10 shareholders and partnerships with more than 10 partners. In addition, preparers that expect to prepare more than 10 corporation or partnership returns would be required to file these returns electronically. The IRS is happy to work with this Committee on this proposal.

While the IRS continually strives to improve, through streamlining operations and redesigning work processes, our ability to further eliminate manual workarounds is dependent on full funding for IT infrastructure, as included in the 2016 President's Budget Request.

Question: Has IRS examined its business rules for activity that actually generates more work for the IRS downstream?

Response: The IRS's downstream work results from identifying issues on returns and resolving taxpayer errors. These are downstream work activities due to legal restrictions and doing business via paper processes. Some downstream activities, such as audits and collection activities will continue. However, many of these downstream activities can be addressed by IRS operating in a digital and global environment. New legal authority and better access to data sources are also key to eliminating work downstream.

The IRS continually examines its work processes and automated work flows to ensure they accurately reflect the tax law and provide the most efficient means for accomplishing the mission of the IRS. When the IRS identifies an issue on a return, there are several avenues for resolving the issue.

Today, we know that some issues that cause returns to be selected for audit could be handled through online self-service applications. The President's FY2016 budget requests \$34.2 million to support and develop a customer-centric "Service on Demand" strategy and tools. Our proposal would make tax accounts work much like online bank accounts, thereby simplifying compliance and making tax administration more sustainable. Virtual assistance and digital self-service tools could help taxpayers quickly identify issues and resolve errors. With faster error resolution, we could identify issues when the return is filed and we would communicate with taxpayers up-front, so that the majority of taxpayers could resolve issues sooner. These enhancements would reduce the need for business rules that result in more downstream work for the IRS. While the IRS will continue to audit returns, these enhancements would focus IRS audit resources on the most complex case work.

ABLE Act

Question: What is the cost of implementing the ABLE Act? Please provide the year-by-year cost and number of full-time equivalents for the FY 2015-2020 period.

Response: The IRS is currently scoping the impact and magnitude of the Achieving a Better Life Experience (ABLE) Act (PL 113-295). Coordination is ongoing across all IRS divisions to ensure implementation of the Act results in the appropriate level of compliance, while controlling for taxpayer burden and government costs. Title I of the Act requires the IRS to issue 529A regulations this summer, while considering our current budget limitations, resources, and IT challenges. IT support is expected to be a substantial and critical component to implementing this new legislation, and we do not have estimates of the full multi-year costs for IT support at this time. For FY 2015, the IRS estimates it needs roughly 35 FTEs in addition to \$5 million in IT contract resources to begin system design work to support implementation of the Act's multiple provisions. This estimate is for FY 2015 only, and does not include costs for FY 2016 and beyond necessary for full implementation. The IRS anticipates that the FTE and IT support costs for FY 2016 and beyond will be significantly greater than the initial FY 2015 investment. In addition, this does not include any costs that may be incurred by other agencies.

User Fees

The user fees that Federal agencies charge the public are suppose equal the cost of providing a good or service. The IRS charges fees for a variety of services, taking in roughly \$350 million a year. But as of the end of September 2014, over \$250 million in unspent fees had accumulated.

Question: What is the purpose of having such a large balance of unspent fee income?

Response: Typically prior year user fee balances are used to pay for current year costs. This practice allows for more effective budgeting because the IRS has a better idea of the amount that it will have available prior to current-year collections. The challenges associated with recent budget cuts have required the IRS to spend a larger than normal amount of current-year collections to fund certain necessities such as main frames and server support. We currently estimate that the balance of user fees available to invest will drop to nearly zero in FY 2016. This decrease will reduce our ability to rely on user fees and could lead to inconsistent budgeting for certain programs.

User fees are fees collected by the IRS for services provided by the IRS to taxpayers. Public Law 103-329 states: "The Secretary of the Treasury may spend the new or increased fee receipts to supplement appropriations made available to the Internal Revenue Service appropriations accounts in fiscal years 1995 and thereafter." The IRS determines the use of user fees based on agency-wide requirements and the total IRS funding availability. As the IRS appropriated budgets have decreased year after year, we have increasingly applied user fees to deliver mission-critical programs – including providing for unfunded legislative mandates, filing season support and critical IT investments in support of our highest and most pressing priorities. Maintaining a balance in this account has been necessary to ensure the IRS has the ability and flexibility to implement such unfunded requirements without severely affecting other mission critical requirements. However, the IRS expenditure of user fee balances has exceeded receipts since 2012; as a result, the user fee account balance has decreased by approximately \$200M. This means the IRS will face a tremendous amount of risk if our appropriated resource levels

cannot maintain current levels, especially if the IRS receives other legislative mandates, or if the IRS takes any additional reductions.

Question: Are the fees too high?

Response: No, the IRS does not believe user fees are too high. The IRS reviews all user fees biennially as required by OMB Circular A-25. We follow the guidance in that Circular to estimate the full cost of user fee activities. The Government Accountability Office audited our user fee program in November 2011 and did not identify any user fees that were charged above full cost.

Additionally, to assist low-income taxpayers, some fees charged are less than the full cost of the service provided. During the biennial review, IRS considers the impact on low-income taxpayers when recommending new rates. In particular, the installment agreement fee charged to low-income taxpayers has remained at the same rate since implementation in 1994 and the Offer-in-Compromise (OIC) low-income fee waiver has remained in place since implementation in 2006. Also, to encourage taxpayers to use an automated payment strategy that has been shown to reduce delinquencies and reduce IRS's costs, we charge less-than-full cost for Direct Debit Installment Agreements.

Question: Does the IRS charge more in fees than the cost to the IRS of providing those services?

Response: The IRS follows the guidance of OMB's Circular A-25, which does not permit the IRS or other agencies to charge more in user fees than the full cost of providing services. As required by OMB Circular A-25, every two years the IRS reviews the cost of providing services for which we charge user fees and considers whether to adjust fees. We follow the guidance in that Circular to estimate the full cost of user fee activities. The Government Accountability Office audited our user fee program. In their report issued November 2011, they did not note any user fees that were charged above full cost. Because some fees are set below full cost, the IRS recovers roughly half of the costs associated with its user fee activities.

Question: When was the last time that IRS reduced a user fee?

Response: The IRS has reduced the fee for Income Verification Express Service twice since its implementation in 2006. The fee was reduced on October 1, 2009, and again on October 1, 2011. The fee for a photocopy of a tax return was reduced on October 1, 2013. Certain fees for letter rulings and determinations were reduced on February 2, 2014. As mentioned above, the low-income rates for installment agreements and OIC have remained in place since the implementation of the fees.

Transportation Excise Tax

The Treasury Department and IRS added the application of the air transportation excise tax to aircraft management fees to the Priority Guidance Plan in November 2013 and it has remained

ever since. The Plan does not place any deadline on completion of projects, but the plan does represent projects that are intended to be actively worked on.

Question: Please describe the work accomplished on the application of the air transportation excise tax to aircraft management fees during 2013 and 2014, the number of comments received from taxpayers and tax practitioners related to this project, the number of offices and staff participating in this project, and the work planned for this project during 2015 and 2016.

Response:

The Office of Chief Counsel and the Treasury Office of Tax Policy have been developing the legal and factual issues underlying the question of whether and, if so, when, the air transportation excise tax should apply to aircraft management arrangements. Much of the existing guidance on this question was issued in the years before the current industry practices developed. While there are commonalities, each aircraft management company has its own methods of operation, and each aircraft owner may contract for a range of services that vary from owner to owner. The IRS and Treasury have met with industry representatives several times during the past two years to discuss both the legal framework and the industry practices necessary to develop an understanding of the issues.

Over the course of this project and in connection with meetings with the industry, the industry representatives have provided approximately 10 sets of written comments with suggested approaches to the air management issue. In addition, we have talked with IRS excise examination agents and representatives of the Federal Aviation Administration (FAA) to learn more about how the industry operates.

501(c)(4)

During the hearing you testified that your “goal is not do anything looks like we are trying to impact the next election” with regards to the expected 501(c)(4) draft regulation. The next election will occur in November 2016. In order to not affect that election, the final regulation must be effective as of 2015 or as of 2017.

Question: In which calendar year will the 501(c)(4) final regulation be effective?

Response: In 2013, the Treasury Department and the IRS issued a notice of proposed rulemaking on this topic. The proposal generated over 150,000 written comments – the most ever received by Treasury and IRS on a proposed tax regulation. We are fortunate to have received guidance and input from members of Congress from both sides of the aisle, and from the various other parties—from across the political spectrum—who commented on the initial iteration of the proposed rule. Our goal is to fashion a rule that is clear, fair to everyone, and as easy to administer as possible. It is important to us that the underlying rulemaking proceedings be transparent and open to public input. We will continue to keep you apprised of the status of the rulemaking process, and, of course, any future version of a proposed rule will be noticed and submitted for comment in accordance with the law. We are also committed to holding a public

hearing before finalizing any regulation on this topic, but the details, including the location and number of hearings, have not yet been decided. Although we cannot say for certain when the final regulations will be effective, we expect that they will not be effective before 2017.

Question: Given the record number of comments on the first 501(c)(4) regulation, will the IRS hold more than one public hearing?

Response: See answer above.

Question: Will the IRS hold public hearings out of the Washington, DC area?

Response: See answer above.

Tax Audit Processes

An August 28, 2014, IRS Memorandum (Control Number: SBSE-04—814-0064) provides new guidance on unagreed case processing. Since this new guidance was issued, taxpayers throughout the country have been receiving a series of audit letters which allow them a very short timeframe in which to respond. In many cases a taxpayer's receipt of IRS Letter 3572 is followed quickly (in some instances on the same day) by IRS Letter 5262, which states the requested information has not been received.

Question: What is the sequence of letters that should be sent out following an initial contact such as Letter 3572?

Response: The following responses represent the current IRS processes and procedures. However, in light of recent concerns and issues that have been raised, the IRS is undertaking a review of the existing practices and procedures concerning a taxpayer's right to an administrative appeal and will take appropriate action to ensure the protection of taxpayer rights is maintained.

Question (a): How much time should pass between the issuance of each letter?

Response:

- Letter 3572, SBSE Office Exam Call-Back Appointment Letter, requests that the taxpayer call within 10 days from receipt of the letter to schedule an appointment, and includes Form 4564, Information Document Request, requesting information to resolve the issues identified; examiners are instructed to allow the taxpayer fourteen calendar days from the date the IRS sends the letter to respond, to account for mailing time.
 - If the taxpayer does not respond to the initial contact letter, the examiner will make additional attempts to contact the taxpayer by phone and/or mail to ensure the taxpayer received the initial contact letter, or identify a more current address.
- Letter 3573, SBSE Office Exam Appointment Confirmation Letter, is sent after the appointment is scheduled to confirm the date, time and location of the appointment.
- During the audit, the examiner will work with the taxpayer and allow the taxpayer a reasonable timeframe to respond to requests for information. The timeframe is

determined on a case by case basis and is affected by the availability of information and complexity of issues.

- Letter 5262, Examination Report Transmittal-Additional Information Due (Straight Deficiency), is only issued if the taxpayer and/or the taxpayer's designated representative or a third party does not provide requested information timely and the taxpayer does not confirm they have no additional information. Letter 5262 gives the taxpayer 15 days from the date on the letter to respond and provides the taxpayer an opportunity to (1) provide requested information, (2) agree to the proposed changes, (3) confirm they have no additional information, or (4) request a meeting with the examiner's supervisor.

Question (b): Under what circumstances should a taxpayer under examination receive a "30-day" letter?

Response: When an examiner is proposing an adjustment to the taxpayer's tax return after the taxpayer and/or the taxpayer's designated representative has provided requested information or the taxpayer has confirmed they have no additional information, a 30-day letter is issued. A 30-day letter is a letter used to transmit an examination report which explains proposed changes to a taxpayer's return. The 30-day letter informs the taxpayer of what to do if they agree or disagree with the proposed changes, explains available appeal rights and requests a response within 30 days. It also explains that if they don't respond by the response due date, their case will be processed based on the proposed changes and they will be sent a Notice of Deficiency or other appropriate action will be taken.

Question (c): When should Letter 5262 be issued?

Response: During the audit, the examiner will work with the taxpayer and allow the taxpayer to respond to requests for information within a reasonable timeframe. The timeframe is determined on a case by case basis and is affected by the availability of information and complexity of issues. Letter 5262, Examination Report Transmittal-Additional Information Due (Straight Deficiency), is only issued if the taxpayer or a third party does not provide requested information timely and the taxpayer does not confirm they have no additional information. Letter 5262 gives the taxpayer 15 days from the date of the letter to respond and provides the taxpayer an opportunity to (1) provide requested information, (2) agree to the proposed changes, (3) confirm they have no additional information, or (4) request a meeting with the examiner's supervisor. If a taxpayer provides requested information or confirms they have no additional information, in response to Letter 5262, a 30-day letter can be issued.

Question: What is the definition or criteria of an "unagreed" case?

Response: An unagreed case is one where the taxpayer does not agree with any of the proposed examination changes. If the taxpayer agrees with some, but not all, of the proposed changes, the case is "partially agreed."

Question: How does the IRS determine that a taxpayer is or is not eligible for an appeals conference, and what is the standard timeframe for making this determination?

Response: At the conclusion of the examination when the taxpayer has provided the information requested and confirmation is received that there is no additional information to resolve outstanding issues, the taxpayer will receive a 30-day letter. If the taxpayer does not agree with some or all of the proposed changes, the 30-day letter will notify the taxpayer that the taxpayer may appeal Compliance's determination.

NOTE: There must be at least 365 days remaining on the assessment statute (270 days for estate tax cases or IRC 6206 excessive claim cases) in order for the case to be forwarded to Appeals.

Question: Once a Notice of Deficiency is issued an audit case enters the Tax Court system. What percentage of taxpayers proceed with litigation?

Response: The issuance of the Notice of Deficiency does not automatically enter a case into the Tax Court system. Once a Notice of Deficiency is issued, the taxpayer normally has 90 days to either agree to the deficiency or file a petition with the United States Tax Court. If the taxpayer does not file a petition with the Tax Court, the IRS will assess the amount on the Notice of Deficiency. We do not measure or report on the percentage of taxpayers who are issued a Notice of Deficiency and proceed to litigation.

Question: The Taxpayer Bill of Rights includes "The Right to Appeal an IRS Decision in an Independent Forum." Taxpayers are being warned in Letter 5262 that if they do not respond within the prescribed timeframe they will lose their appeal rights.

Is there a process in place that allows a taxpayer to appeal an IRS decision in an independent forum if they miss the deadlines for responding to the letters?

Response: The Taxpayer Bill of Rights provides that taxpayers are "entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court."

- A taxpayer is generally eligible for an Appeals conference before the issuance of a Notice of Deficiency if the taxpayer provides information requested, or the taxpayer or the taxpayer's representative confirms that there is no additional information to resolve the outstanding issue(s). Generally, new information provided to Appeals that was not provided during the audit, and in the judgment of the Appeals Officer merits additional investigation, will not be considered in the first instance by the Appeals Officer, but will be returned to Compliance for consideration.
- If the taxpayer fails to respond to the letters issued by the IRS and the taxpayer does not contact the IRS to request a meeting, the taxpayer will be issued a Notice of Deficiency.
- If the taxpayer does not receive an opportunity to appeal before a Notice of Deficiency is issued, they will generally have the opportunity for a pretrial settlement/administrative appeal, if they petition the Tax Court.

Note: The Office of Chief Counsel generally refers these cases to Appeals for settlement consideration before preparing for trial.

Questions for the Record Submitted by Congressman Steve Womack

Rural Access to Taxpayer Services

I understand it is a tough budget environment for a lot of people right now. However, my office has received reports that Arkansas's levels of service have gone down due to the IRS concentrating taxpayer assistance resources in population-dense areas. This is concerning to me.

Question: How can you ensure that all taxpayers who need it, including rural Arkansans, have access to your services?

Response: In order to serve the most taxpayers, the IRS is leveraging the variety of services available on IRS.gov and those provided by our partner organizations. Taxpayers are encouraged to take advantage of the many resources available at any time on IRS.gov. These offerings include online forms and publications, interactive tax law tools, Where's My Refund?, Direct Pay, Online Payment Agreement, and Understanding Your IRS Notice or Letter. Those without internet access can use their telephone to access toll-free automated response systems that provide recorded information on a variety of tax topics. We also created the IRS Services Guide to help taxpayers and practitioners locate the services they need (<http://www.irs.gov/pub/irs-pdf/p5136.pdf>). For the future, we intend to build toward a new approach that centers on improving online assistance and account management to taxpayers, who increasingly demand these types of service, while at the same time taking steps to safeguard taxpayer information and prevent identity theft and fraud.

Arkansans who are low to moderate-income taxpayers, senior citizens, persons with disabilities, those with limited English proficiency, and Native Americans can take advantage of the free tax preparation services offered by Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE). Annually, more than 12,000 VITA/TCE sites open nationwide to serve taxpayers. Of the 82 VITA/TCE sites in Arkansas, 33 are in rural counties.

Taxpayers also have the option to use Free File and Free File Fillable Forms to prepare their return at no cost. Taxpayers can choose from a variety of online software options based on the taxpayer's adjusted gross income.

In situations where the taxpayer believes their tax issue can only be handled face-to-face, the IRS has Taxpayer Assistance Centers (TACs). There are four TAC locations in Arkansas -- Fayetteville, Ft. Smith, Jonesboro, and Little Rock. These locations provide services such as identity authentication and account resolution which may require in person assistance.

The Jonesboro Arkansas TAC also offers a video conferencing option. Taxpayers who visit the TAC may receive assistance provided by an employee physically located in a remote office, with both using a computer monitor to communicate with each other remotely. It is similar to talking face-to-face with an employee in the office, except the employee is sitting in a different location from the taxpayer in the TAC. Using this technology, taxpayers may be able to resolve issues

such as: account inquiries, adjustments, application for Taxpayer Assistance Order (ATAO), multilingual assistance, payment arrangements, solutions to tax issues, tax form orders, tax law assistance, and taxpayer identification numbers.

Impact of PPACA Implementation at IRS

I understand that the IRS is challenged to attend to its core mission of customer service and enforcement due to PPACA's increase in regulation and enforcement.

Question: With the implementation of PPACA's tax provisions in hitting its stride this year, what are the metrics for the increased workload of the IRS?

Response: There are almost 50 tax provisions contained in the Affordable Care Act (ACA), most of which were effective prior to 2014. Two significant provisions were effective in 2014 – the Individual Shared Responsibility Provision and the Premium Tax Credit. These provisions affected the 2015 income tax filing season that recently concluded. Implementation of these two new provisions cannot be separated from the responsibility to provide customer service and enforce the nation's other tax laws. For example, prior to the beginning of the 2015 filing season, the IRS included projections and accounted for the need to provide customer service (e.g., taxpayer calls and correspondence), as well as implementation of these two provisions.

Although the IRS maintains many metrics, perhaps one measure relevant for the issue of "increased workload" is the number of employees working on ACA implementation. In the President's FY 2015 budget, the IRS projected requirements of approximately 2,046 full-time equivalents (FTE) related to the ACA: through April 30, 2015, the IRS has expended approximately 1,158 FTE. This amount includes FTEs to implement both the Marketplace provisions (such as the premium tax credit provision) and non-Marketplace provisions (such as the fee on branded drug manufacturers). The current full year FTE estimate for the ACA program is 2,828 FTEs, which is approximately 3.5% of FY 2015 the IRS operating plan.

Question: Once the PPACA implementation problems are worked out, will the IRS be able to divert some of its resources back toward core mission activities?

Response: The IRS successfully implemented the Individual Shared Responsibility and Premium Tax Credit provisions this filing season. As of April 17, 2015, we have received over 132 million individual income tax returns and have not experienced any significant issues in accepting or processing these returns.

As noted above, the IRS does not consider customer service and enforcement and implementation of the ACA to be distinct priorities. Taxpayer service will continue to suffer if funds are not appropriated to the IRS for ACA implementation, including the increased demand for customer service and enforcement as a result of ACA, as described in the President's Budget. To help fund implementation, the IRS needed to reallocate base appropriations and non-appropriated resources, including user fees and the Health Insurance Reform Implementation

Fund (HIRIF) to cover ACA implementation costs. This will continue into FY 2016 and FY 2017 as there are still significant portions of the ACA to be implemented in those years, including receipt of information returns from insurers and employers. We expect user fees balances to zero out in FY 2016. Therefore other core services at IRS, including enforcement and taxpayer services, will suffer even more severely from budget shortfalls than they did in FYs 14 and 15. As we move forward, the President's Budget outlines the investments that would ensure IRS is able to successfully deliver its core mission including legislative mandates such as the ACA.

Question: Of the investments you made in software, filing, and other IT programs for PPACA, how much of that can you transition into the core mission duties?

Response: The largest cost associated with ACA implementation is the set of IT investments needed to implement the law. While some of those expenditures were one-time costs, the majority of the costs are associated with operating and maintaining these systems to support interrelated tax administration, taxpayer service and enforcement business processes. In addition, the IRS is readying itself for the mandatory issuer and employer information reporting in 2016 and has needed to find funding for associated IT costs.

Questions for the Record Submitted by Congressman Mark Amodei***Gaming***

The IRS may consider cutting in half the tax information reporting threshold on slot machine winnings - from \$1,200 down to \$600. No other industry in America has to take its assets out of production to do tax information reporting (on someone else's income). In this reporting process, the slot machine goes out of service after a \$1,200 win, so all of the IRS paperwork can be filled out. The casino loses half an hour of business revenue in the process. Cutting the IRS reporting threshold in half will increase loss of business revenue for the casino. Today's threshold level of \$1,200 was set back in the 1970s and has not been adjusted for inflation for the value of \$1,200 today.

Question: The gaming industry historically has had a good working relationship with the IRS. Will you and your staff commit to working closely with the gaming industry to address its concerns about this proposed guidance?

Response: Yes. We have solicited comments from all stakeholders in the Notice of Proposed Rulemaking and welcome their comments. We are actively encouraging all stakeholders to participate so that we can craft appropriate rules going forward. To this end, Treasury and IRS held a meeting with the American Gaming Association on April 28 to listen to their concerns.

Question: What is the reason for the lower threshold of reporting to \$600 from \$1,200?

Response: The reporting threshold is not being changed in the proposed regulation. The Notice of Proposed Rulemaking proposes to keep the existing thresholds the same - \$1,200 for bingo/keno and \$1,500 for slots. Because these thresholds vary from the statutory amount of \$600 in I.R.C § 6041, the proposed rule specifically solicits comments on the proposed reporting thresholds, including whether the IRS should or should not reduce the thresholds to the statutory amount. The IRS also would welcome the opportunity to work with the Congress on any future proposed legislative changes to the reporting threshold for gambling winnings.

Question: Have you considered the burden of revenue loss of the part of the Casino's for taking a machine out of commission?

Response: The purpose of the proposed rule is to modernize reporting, and we are asking for industry and other relevant input into the most efficient way to do so. We will consider all relevant factors raised by comments submitted in response to the request for comments in the Notice of Proposed Rulemaking before issuing a final rule.

Question: Has the IRS ever considered adjusting the threshold for inflation?

Response: We will consider all comments regarding these thresholds received in response to the Notice of Proposed Rulemaking.

Process ROI

Topic 3 Background: Reports indicate that taxpayers making between \$100,000 and \$199,999 thousand dollars a year pay the largest portion of taxes (for filed returns) than any other income group. In 2012, they contributed 22% or \$265.4 million. Taxpayers with income levels between \$50,000 and \$74,999 typically file the most returns but contribute less than the previous category. So from what I gather from these fact, it appears 35% or so of all individual taxpayer filings each bring in around \$500 million a year in revenue to the federal government?

Question: How much total, considering all involved departments and taxpayer services, How much does the IRS spend collecting revenue from these two categories?

Response: The IRS does not track collections by the size of the individual's income level, and therefore does not have the necessary data to provide the analysis you have requested.

Question: How much revenue did the IRS collect from these two categories in the most recent data-available year? Is this even cost effective, and what sort of resources and expense does the IRS spend auditing individuals or small businesses in these categories?

Response: The IRS does not track collections by the size of the individual's income level, and therefore does not have the necessary data to provide the analysis you have requested.

Air Management Services

In March of 2012 an IRS Chief Counsel opinion concluded that aircraft owners employing aircraft management services that allow the use of the aircraft for occasional charter operations should be assessing the 7.5 percent commercial ticket tax on amounts paid for those management services. Aircraft management services typically include hiring, training, and scheduling pilots and other personnel; fueling the aircraft; conducting weather and flight planning; and overseeing key safety standards. The IRS interpretation is unprecedented as all aviation taxes are movement based. If an owner is using an aircraft for personal reasons, the fuel tax is assessed. The same aircraft, used by a management company for charter services, assesses the commercial ticket tax (i.e. federal excise tax (FET) on the charter customer).

After a significant number of operators successfully appealed audit findings assessing the FET to aircraft management services, the IRS opinion was put on hold in May of 2013. Since then the National Air Transportation Association has been in constructive dialogue with Treasury and IRS and the issue has been placed on the IRS's priority guidance list for a second consecutive year. However, the Treasury/IRS has not committed itself to a timeline for resolution.

Question: What is the current status of this guidance and will you commit to releasing it by the end of the second quarter of this year?

Response: Before addressing the question, it is helpful to clarify the operation of the air transportation excise tax. This tax is sometimes referred to as a "collected" tax, meaning the tax

is imposed on the amounts paid for air transportation, but it is collected by the person who receives the payment and that person remits the tax to the government. So the air transportation tax operates somewhat like a sales tax on air transportation services. The March 2012 Chief Counsel opinion referenced in your question relied on longstanding revenue rulings that focus on whether the owner or the aircraft management company had "possession, command and control" over the aircraft. These rulings apply to owners of aircraft whether the flight is for personal or business reasons. If the owner is in possession, command and control of the aircraft, then a higher fuel tax applies than in the case of a commercial flight.

The Chief Counsel opinion concluded that the typical aircraft management company has possession, command and control in these cases because the aircraft management company undertakes all responsibility for the flight, including employment of the pilot and crew that provides the actual transportation service in flying the plane, as well as other services necessary to providing the air transportation, e.g., flight preparation and planning, FAA compliance, etc. Many members of the aircraft management industry disagreed with that opinion. They argue that the owner retains possession, command and control because the owner may direct departure times, destinations, speed, course and other operations of the plane within the parameters of the FAA rules.

In order to better understand industry practices, and to determine whether the air transportation excise tax should apply to these arrangements, the IRS Office of Chief Counsel and the Department of Treasury's Office of Tax Policy met with industry representatives on several occasions. The industry has suggested in those meetings and in subsequent submissions that the facts set forth as the basis for the March 2012 opinion are not accurate. Consequently, in addition to meetings with the industry to learn the facts about how the industry operates, the Office of Chief Counsel and the Office of Tax Policy have held conference calls with the FAA and IRS examination agents and undertaken their own research in order to determine what guidance is appropriate to address these issues. We recognize the need to provide guidance regarding the taxation of air management company fees to taxpayers and IRS examination agents as soon as practicable. We will continue to work diligently on the project as we balance that effort with the other responsibilities and priorities of the IRS, the Office of Chief Counsel and the Office of Tax Policy.

Questions for the Record Submitted by Ranking Member José Serrano*Tax Gap*

Question: What progress are you making addressing the Tax Gap?

Response: Addressing the tax noncompliance reflected in the tax gap estimates requires a broad based strategy that both facilitates and fosters improvements in voluntary compliance and provides for effective detection, correction, and enforcement, as appropriate, when voluntary compliance on the part of taxpayers is not realized. Large increases in compliance would require additional resources and effort on the part of the entire tax community—taxpayers, preparers, and the IRS and consideration must be given to the benefits and costs to achieving extremely high levels of tax compliance. The IRS's efforts to sustain and improve compliance and address the tax gap involve a broad set of activities.

Failures to comply with tax law can involve unintentional mistakes that are the result of not fully understanding what has become an extremely complex tax code. For that reason, efforts to increase tax compliance must also include programs to educate taxpayers in their tax obligations, along with efforts to improve taxpayer service, to make it easier for individuals and businesses to fulfill their tax responsibility.

Despite the many challenges, the IRS has been and continues to be committed to finding ways of improving tax compliance, particularly voluntary compliance, which is the cornerstone of our tax system. From a revenue standpoint, the importance of voluntary compliance cannot be overstated: Each additional percentage point of voluntary compliance established brings in about \$30 billion in tax receipts. Therefore, any loss of public confidence in the proficiency and fairness of the IRS, which reduces voluntary compliance, would come at a high cost, and the effects of a reduction in voluntary compliance would take a long time to reverse.

Achieving greater voluntary compliance involves a comprehensive, integrated long-term strategy. Along with increased enforcement activities which enhance confidence and fairness in the tax system, a comprehensive strategy must also include: expanding compliance research; improving information technology; reforming and simplifying the tax law; coordinating with states, foreign governments, and other partners and stakeholders to share information; and, as noted above, enhancing taxpayer service.

The IRS's program for implementing legislation on merchant card reporting is a good example of our recent efforts to narrow the \$122-billion portion of the tax gap that represents underreporting of business income by individuals. This program involves requiring payment settlement entities to send us information on Form 1099-K.

Congress enacted the reporting requirement because lawmakers understood that cash and credit card transactions underlie much of the income underreporting by small businesses. Bad actors who wanted to gain an unfair advantage over law-abiding taxpayers could do so simply by not

reporting all of their transactions. Therefore, in addition to helping improve tax compliance, the Form 1099-K reporting regime also helps level the playing field for small businesses.

The challenge for the IRS is determining how to properly use the data gleaned from the Form 1099-K, as reported income is generally a mix of credit card and cash receipts. The IRS has found the Form 1099-K allows us to compare similar businesses, spot anomalies, and follow up with businesses to determine why those anomalies exist. In fact, we are already beginning to notice an impact from this new reporting regime.

The IRS has worked to use the information received from the Form 1099-K while minimizing the burden on small businesses by seeking input from the business community on this program and by giving taxpayers extra opportunities to respond, fix errors, or explain their situation. In fact, most taxpayers contacted by the IRS have responded to our notices, and have taken the opportunity to explain unusual circumstances or correct errors, often without an audit. It is important to note that about 60 percent of taxpayers we contacted about potential underreporting of 2011 income increased the amount of income reported in 2012.

Another good example of our recent work to increase tax compliance involves the international tax area in general, and offshore tax avoidance in particular. The IRS has made great strides over the last several years both in finding tax evaders hiding assets overseas and assessing and collecting tax liabilities. The IRS has also encouraged taxpayers to voluntarily disclose their foreign accounts and pay the amount they owe.

The IRS has conducted thousands of offshore-related audits that have produced tens of millions of dollars and, where appropriate, has pursued criminal charges leading to billions of dollars in criminal fees and restitution. Taxpayers have also been given the opportunity to come forward and accurately report their tax liabilities. Since its establishment in 2009, the Offshore Voluntary Disclosure Program (OVDP) has resulted in more than 50,000 disclosures of underpaid or unpaid taxes and the collection of more than \$7 billion in back taxes, interest and penalties.

In 2010, Congress enacted the Foreign Account Tax Compliance Act (FATCA), giving the IRS an important new tool to help us improve offshore tax compliance. This law requires foreign financial institutions (FFIs) to report information to the IRS about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. More than 160,000 FFIs have registered under FATCA, and in March of this year they began supplying the IRS with information about overseas accounts of U.S. taxpayers.

Programs such as Form 1099-K reporting and FATCA are important to address the tax gap, not only because they help the IRS collect the correct amount of tax, but because they encourage voluntary compliance. These efforts to improve compliance help assure the public that when they are paying their taxes, everyone else is paying their fair share as well. Small business owners, for example, should feel confident that when they properly report their cash receipts, other businesses are doing the same. Likewise, a person who can't afford high-priced financial advice should feel confident that those that can afford such advice are not able to hide their money in foreign countries and avoid paying tax on those assets.

This sense of fairness is the underpinning of our system of voluntary compliance. Year after year, the IRS Oversight Board studies taxpayer behavior, and it has consistently found that the vast majority of people -- about three quarters of those surveyed -- believe paying taxes is their civic duty. An even higher percentage of those surveyed believe it is not acceptable to cheat on their taxes. To maintain this sense of responsibility and fairness, we must continue doing everything we can to improve overall tax compliance.

The IRS' budget situation represents a very serious challenge to our ability to continue making progress on this front. The President's 2016 Budget provides \$12.3 billion in base discretionary resources, including strategic investments in the IRS to continue modernizing our systems, improve service to taxpayers, and reduce the deficit through more effective enforcement and administration of tax laws. The Budget also proposes a \$667 million cap adjustment to support program integrity efforts aimed at restoring enforcement of current tax laws to acceptable levels and to help reduce the tax gap. This multi-year effort is expected to generate \$60 billion in additional revenue over the next ten years at a cost of \$19 billion. If enacted and fully funded, this would reduce the deficit by \$41 billion.

Foreign Account Tax Compliance Act (FATCA)

Question: You've mentioned that FATCA, which provides more information about income going offshore, would likely increase compliance. Do you see that happening?

Response: The Foreign Account Tax Compliance Act (FATCA) is an important advance in U.S. efforts to improve tax compliance involving foreign financial assets and offshore accounts.

Under FATCA, U.S. persons with specified foreign financial assets that exceed certain thresholds must report those assets to the IRS. This reporting is made on Form 8938, *Statement of Foreign Financial Assets*, which taxpayers attach to their federal income tax return, starting with the 2011 tax filing season. Foreign financial institutions and tax authorities report specified information with respect to certain U.S. accounts on Form 8966, *FATCA Report*. Taxpayers will likely file Forms 8938 more accurately since account information will also be reported by financial institutions on Form 8966.

The IRS has seen an increasing number of specified foreign financial asset information filings for individuals on Forms 8938 in the last 3 tax years, 2011, 2012 and 2013 (approximate figures provided in the table below). Foreign Financial Institutions and tax authorities will submit Forms 8966 in 2015. These filings are an indication of increased compliance. Future FATCA filings from foreign financial institutions, tax authorities, and entities with specified foreign financial assets will provide the IRS comprehensive visibility into offshore assets and applicable tax compliance.

Form 8938 Filings

Form 8938 became a mandatory filing for individuals starting in tax year 2011. The table below captures the Form 8938 number of filings for TYs 11, 12, and 13 (approximate).

Period*	Forms 8938 filed to date (in thousands)**	% filing increase from prior Year*
Tax year 2011	168	-
Tax year 2012	227	35%
Tax year 2013	284	25%

*Because many taxpayers who are required to file Form 8938 request extensions, the IRS has not yet received a sufficient number of Form 8938s for tax year 2014 to allow for meaningful analysis.

** The values in the table are rough order of magnitude figures based on an analysis of filings that the IRS performed in March 2015.

The effect of FATCA on offshore compliance has been realized, not just in FATCA-specific reporting, but in other offshore areas as well.

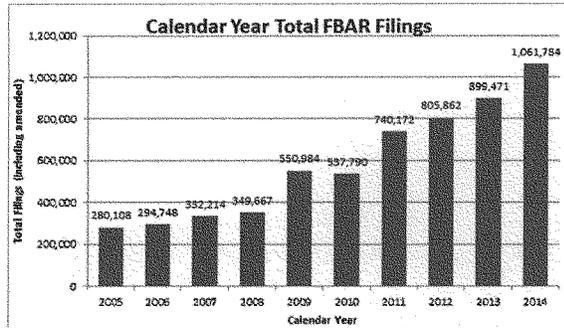
Report of Foreign Bank and Financial Account (FBAR)

Generally, under the Bank Secrecy Act, a U.S. person who has a financial interest in, or signature or other authority over, a foreign financial account must file a FinCEN Form 114, Report of Foreign Bank and Financial Account (FBAR) if the aggregate value of such accounts is more than \$10,000 during the previous calendar year. Although FinCEN Form 114 is not part of the tax return, the IRS is responsible for enforcing compliance with FinCEN Form 114.

The table below captures the FBAR filings for a 10 year period and shows a correlation with FATCA's influence on compliance. Since 2011, FBAR filings have increased each year, which coincides with the requirement under FATCA, to file the Form 8938, *Statement of Foreign Financial Assets* for 2011 income tax returns.

The FATCA statute was written subsequent to the FBAR statute. The Form 8938 filing requirement does not replace or otherwise affect a taxpayer's obligation to file an FBAR form. Individuals must file each form for which they meet the relevant reporting threshold.

Generally speaking, if a taxpayer must file a FATCA Form 8938, there's a high probability that the taxpayer should also file an FBAR Form; however, there are different requirements for filing FBAR and 8938 Forms, so the number of filings and the taxpayer population will have differences.



Business Systems Modernization

Question: Are the technology improvements that you've made going to enable you to make better decisions about where the IRS should do audits?

Response: Yes, technology improvements under the Business Systems Modernization (BSM) program are enabling the IRS to make better decisions about audit selection, among many other areas of decision-making. To fully appreciate the progress we are making, it is important to stress that, at the highest level, data is at the core of the IRS mission and central to everything we do. We rely heavily on our data to accurately and efficiently provide service and apply the tax law fairly, which includes audit selection and other compliance activities.

Our ongoing Data Strategy initiative is helping the IRS business units deliver the mission and achieve our compliance goals by:

- o ensuring the fidelity of our data
- o providing the tools to query and explore the data
- o fostering a means to share and correlate the data
- o understanding the meaning of the data
- o making the data actionable as it relates to audit election and many other activities

IRS's Integrated Production Model (IPM) is another initiative that is helping with audit selection. It is a data repository enabling the IRS to centralize access, analyze and use core taxpayer data from various sources to help IRS employees in many collection and exam activities. IPM data is used for case identification, selection, prioritization, delivery and reporting. IRS employees and other systems can use the various data stored in IPM to conduct taxpayer account analyses, identify trends in non-compliance, and implement measures to address the non-compliance. Investments in the IPM project are enabling IRS business units to make data-driven decisions around compliance and other activities. Recent investments associated with the use of a new technology called "massively parallel processing" are expanding IPM capabilities to a wider IRS community, with improved automation, reliability, and certification of IPM data.

The Customer Account Data Engine 2 (CADE 2) investment is another initiative that enables IRS to more effectively use taxpayer account data to achieve our compliance goals. With better quality of individual taxpayer account data stored in one centralized data base using a comprehensive data model that accurately defines each data element and its relationships to other data elements, the IRS is better able to use its taxpayer account data to make better decisions on mission-related activities, including audit and collection actions. With individual taxpayer data provided daily in new formats through CADE, the IRS can make data-driven decisions faster and better as it relates to audit and compliance activities for taxpayers who are not fulfilling their responsibilities.

The Modernized e-File (MeF) system, which is core to building out systems in the intake phase of tax administration, also contributes significantly to better decision making around audit selection and compliance activities. With extensive error checking and data validation immediately upon receipt of the taxpayer's return, it ensures effective movement of returns through all IRS tax systems, including various filters for non-compliance. MeF also improves IRS's ability to quickly access taxpayer returns and other documentation when needed, to make decisions around audits, as MeF electronically captures 100 percent of the taxpayer's return and other information submitted, including third-party documents such as appraiser statements and state documents that were submitted to the IRS. With taxpayer original documentation online and 100 percent data access by revenue agents' and other IRS representatives, decision-making is enhanced in audit selection.

The Return Review Program (RRP) anomaly detection project is transforming IRS's ability to use its data by leveraging new technologies, such as "massively parallel processing," (mentioned above in reference to IPM) to enhance detection, resolution and prevention of criminal and civil non-compliance. With predictive fraud and non-compliance detection models that seek out data patterns to determine reliability of a taxpayer's return, including a taxpayer's identity, the IRS is better able to see patterns of non-compliance and apply compliance resources more effectively. With RRP, the IRS has a more comprehensive understanding of the data in a taxpayer's return, with capabilities to evaluate current returns against the prior three years' filing history and other external data sources. This more comprehensive view of a taxpayer's return enables more detailed analysis and efficiencies in selecting returns that are non-compliant.

While the IRS continues to struggle with reduced budgets and resources to apply toward all of its activities, investments in our information technology investments, in particular the initiatives highlighted above, enable us to provide enhanced tools and data that help us make better decisions around audits.

Questions for the Record Submitted by Congressman Mike Quigley

Same Sex Marriage Filing

After DOMA was struck down by the Supreme Court in 2013, married same-sex couples had the ability to file federal taxes together for the first time during the last filing period.

Question: Following this incredibly significant change in federal law, are you aware of any significant implementation issues and, if so, what do you think the IRS must do to address these issues?

Response: In August 2013, Treasury and the IRS issued Revenue Ruling 2013-17, implementing the Supreme Court decision in *United States v. Windsor*. Subsequently, Treasury and the IRS issued several items of additional guidance clarifying specific issues related to the implementation of the *Windsor* decision, such as how retirement plans needed to treat same-sex married couples. The guidance issued in Revenue Ruling 2013-17 was effective for 2013 tax year returns filed in 2014. No significant implementation issues arose during the 2014 or 2015 filing seasons.

Question: What has the IRS done to educate taxpayers about this change and what resources have you provided, or plan to provide, for same-sex marriage filers during this transition?

Response: Guidance as well as frequently asked questions about implementation of *Windsor* is available on the IRS website at the following links:

<http://www.irs.gov/uac/What's-Hot> -- Information about items of current interest — new programs, recent guidance or timely reminders.

<http://www.irs.gov/Retirement-Plans/Treatment-of-Marriages-of-Same-Sex-Couples-for-Retirement-Plan-Purposes> -- Guidance on how qualified retirement plans should treat the marriages of same-sex couples following the Supreme Court's decision in *United States v. Windsor*.

<http://www.irs.gov/pub/irs-drop/n-14-19.pdf> -- Notice 2014-19 to provide guidance on the application (including the retroactive application) of the decision in *United States v. Windsor* to retirement plans qualified under section 401(a) of the Internal Revenue Code.

<http://www.irs.gov/Retirement-Plans/Application-of-the-Windsor-Decision-and-Post-Windsor-Published-Guidance-to-Qualified-Retirement-Plans-FAQs> -- Questions and answers provide additional information regarding the application of the Supreme Court's decision in *United States v. Windsor* (June 26, 2013) and the holdings of Revenue Ruling 2013-17, 2013-38 IRB 201 (published in the Internal Revenue Bulletin on September 16, 2013) to qualified retirement plans and regarding Notice 2014-19, 2014-17 IRB 979.

A press release was issued in August 2103 announcing the issuance of Revenue Ruling 2013-17 and advising that same-sex couples, legally married in a jurisdiction that recognizes that marriage, will be treated as married for federal tax purposes, regardless of where they live. In addition, tax form instructions (for Forms 1040, 1040A and 1040EZ) were revised to provide similar guidance. This was a topic covered during the 2014 IRS Nationwide Tax Forums in a seminar titled DOMA- Introduction to the Federal Tax Issues of Legally Married Same Sex Couples after the Windsor Supreme Court Case Decision. It was also discussed during meetings with professional organizations. The IRS also responded to questions sent by members of Congress and groups, such as the AICPA and American Payroll Association.

Identity Fraud

I was shocked to read in a recent GAO report that the IRS is estimated to have paid out \$5.8 billion in fraudulent refunds last year. That's an increase of over 60 percent since 2011.

Question: What would you attribute to this increase?

Response: In January 2015, the GAO reported the IRS paid \$5.8 billion in identity theft refund claims for tax year 2013. In the same report, they said the IRS prevented or recovered \$24.2 billion in identity theft refund claims. While the amount paid is an estimate, these numbers reflect the IRS prevented payment of more than 80% of identity theft claims in that year.

The GAO numbers are based on the IRS's Identity Theft Taxonomy, a study which estimated the number of returns and amount of identity theft. The Identity Theft Taxonomy estimate began in tax processing year 2012. The 2013 amount represents a decrease of 38.3% of lost revenue from the amount in 2012. The Identity Theft Taxonomy numbers for tax processing year 2014 are still being developed.

Question: What is the IRS doing to adapt to the evolving challenges of identity theft and in your opinion, do you think we can get in front of this issue without additional investments in IT?

Response: Fighting identity theft and refund fraud is an ongoing battle for the IRS, and we must remain vigilant, given the propensity of identity thieves to develop new and more complicated schemes. For that reason, and in spite of our budget constraints, we have continued to focus as much of our resources as possible on improving our efforts against identity theft.

We continue to improve the filters we use to detect suspicious returns as they come in, which helps us stop fraudulent refunds before they are issued. Beginning this filing season, we limited the number of tax refund deposits in a single account to three. We also started receiving Device ID information to identify potential ID theft or fraud. The Device ID is the serial number (or fingerprint) of the device (for example, Computer, Smart Telephone, or Tablet). The unique ID is transmitted as part of the electronically filed return via our existing transmission process and enables the IRS to easily associate fraudulent returns that were filed from the same device.

In calendar year 2014, our efforts have suspended or rejected 5.6 million suspicious returns. We stopped 1.8 million confirmed identity theft returns, totaling \$10.8 billion of stopped refunds. Additionally, we stopped \$5 billion worth of refunds for other types of fraud, totaling \$15.8 billion of confirmed fraudulent refunds protected.

While this is important progress, we need to do more.

In March, we held a sit-down meeting with the leaders of the tax software and payroll industries and state tax administrators. We agreed to build on our cooperative efforts of the past and find new ways to leverage this public-private partnership to help battle identity theft.

We formed three working groups that are continuing to meet, and over the next couple of months we expect to come to agreement on short-term solutions to help taxpayers in the next tax season, and work on longer-term efforts to protect the integrity of the nation's tax system. One of the three working groups focuses on authentication. As criminals obtain more personal information, authentication protocols need to become more sophisticated, moving beyond information that used to be known only to individuals but now, in many cases, is readily available to criminal organizations from various sources. We must balance the strongest possible authentication processes with the ability of taxpayers to legitimately access their data and use IRS services online. The challenge will always be to keep up with, if not get ahead of, our enemies in this area. The eventual approaches to authentication may include a combination of continued IT investments as well as modified business processes.

We continue to work with other federal agencies across government to identify best practices, leverage information and identify broader solutions.

Congress can help us in the fight against refund fraud and identity theft, by passing several important legislative proposals in the President's FY 2016 Budget proposal, including the following:

- **Acceleration of information return filing due dates.** Under current law, most information returns, including Forms 1099 and 1098, must be filed with the IRS by February 28 of the year following the year for which the information is being reported, while Form W-2 must be filed with the Social Security Administration (SSA) by the last day of February. The due date for filing information returns with the IRS or SSA is generally extended until March 31 if the returns are filed electronically. The Budget proposal would require these information returns to be filed earlier, which would assist the IRS in identifying fraudulent returns and reduce refund fraud, including refund fraud related to identity theft.
- **Correctible error authority.** The IRS has authority in limited circumstances to identify certain computation or other irregularities on returns and automatically adjust the return for a taxpayer, colloquially known as "math error authority." At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific, newly enacted tax code amendments. The IRS would be able to significantly improve tax

administration – including reducing improper payments and cutting down on the need for costly audits – if Congress were to enact the Budget proposal to replace the existing specific grants of this authority with more general authority covering computation errors and incorrect use of IRS tables. Congress could also help in this regard by creating a new category of “correctible errors,” allowing the IRS to fix errors in several specific situations, such as when a taxpayer’s information does not match the data in certain government databases.

- **Authority to regulate return preparers.** In the wake of court decisions striking down the IRS’ authority to regulate unenrolled and unlicensed paid tax return preparers, Congress should enact the Budget proposal to provide the agency with explicit authority to regulate all paid preparers. The regulation of all paid preparers, in conjunction with diligent enforcement, would help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system.
- **Expanded access to Directory of New Hires.** Under current law, the IRS is permitted to access the Department of Health and Human Services’ National Directory of New Hires only for purposes of enforcing the Earned Income Tax Credit and verifying employment reported on a tax return. The proposal would allow IRS access to the directory for individual income tax administration purposes that include data matching, verification of taxpayer claims during return processing, preparation of substitute returns for non-compliant taxpayers, and identification of levy sources.

There are a number of other legislative proposals in the Administration’s FY 2016 Budget request that would also assist the IRS in its efforts to combat identity theft, including: giving Treasury and the IRS authority to require or permit employers to mask a portion of an employee’s Social Security Number (SSN) on W-2s, which would make it more difficult for identity thieves to steal SSNs; adding tax-related offenses to the list of crimes in the Aggravated Identity Theft Statute, which would subject criminals convicted of tax-related identity theft crimes to longer sentences than those that apply under current law; and adding a \$5,000 civil penalty to the Internal Revenue Code for tax-related identity theft cases, to provide an additional enforcement tool that could be used in conjunction with criminal prosecutions.

It is important to note that these legislative proposals, while they would be very helpful, would only be partially effective in achieving their intended goals without adequate resources for the agency.

The President’s budget includes a request for funding to expand existing programs to improve upfront identification and resolution of identity theft returns and a request for funding to prevent identity theft and refund fraud through the use of advanced technologies and increased staffing.

Ultimately, though, it is investment in our staffing and IT systems that will be critical to properly equipping IRS to combat identity theft. We are finding that tax-related ID theft schemes are growing at an alarming rate with increasing complexity and sophistication. Perpetrators are no

longer just the individual hackers with a personal computer, a list of stolen social security numbers, and prepaid debit cards. Instead, these criminals are part of organized crime networks based around the world which have turned identity theft and tax fraud into a highly lucrative business, with deep resources to employ encryption and anonymizing services to avoid detection. Combating these sophisticated criminals requires significant resources, and our efforts to fight identity theft are severely hampered by the cuts to our budget. We are, however, committed to doing all that we can within our budget constraints to prevent the payment of fraudulent refunds, pursue the perpetrators, and assist identity theft victims. We will continue to make risk-based decisions to apply our available resources to address the areas of highest risk and vulnerability.

EITC Improper Payment Rate

I believe the IRS has studied the EITC improper payment rate. Understanding the sources of the improper rate is critical to figuring how to reduce it.

Question: Could you explain what part of the improper payment rate is attributable to fraud and how much to complexity and confusion?

Response: Please see below.

Question: Is there a reason why IRS can't provide this breakdown, as well as a breakdown between paid preparer and self-prepared error rates, at the same time it provides its annual estimate of the improper payment rate?

Answer: The improper payment rate estimate provides a summary measure that meets the requirements of the Improper Payments Elimination and Recovery Improvement Act (IPERIA), but it is not designed to provide detailed analyses. To gain greater understanding of the nature of noncompliance associated with the Earned Income Tax Credit, IRS conducts periodic compliance analyses that make use of larger sample sizes and provide greater statistical confidence. The most recent of these studies, the EITC TY2006-2008 Compliance Study, was published in August 2014 (<http://www.irs.gov/PUP/individuals/EITCComplianceStudyTY2006-2008.pdf>). It provides information about the frequency of types of errors and their associated magnitudes in dollars; it also compares error rates associated with different types of return preparation. The results from the Compliance Study are informing efforts to complete a new matrix in Appendix C of OMB Circular A-123, which includes new categories for reporting improper payments in order to give management more granular insights into the sources of EITC improper payments and to develop a more effective strategy for reducing program improper payments.

Because it is generally not possible to ascribe motivation or intent to taxpayers during the normal course of a tax audit, for purposes of estimating the improper payment rate, IRS does not attempt to determine whether EITC errors are intentional (fraud) or unintentional (complexity and confusion) or somewhere in between.

The IRS takes the Earned Income Tax Credit (EITC) improper payment rate very seriously and continues to work to make every effort, given limited resources, to reduce improper payments through enforcement, education, and outreach. At the same time, Treasury recognizes the important role of the EITC in keeping families out of poverty and encouraging work. The EITC is one of the most effective Federal anti-poverty programs. It helps about half of all parents at some point, and together with the refundable Child Tax Credit, keeps about 10 million Americans out of poverty each year.

Tax Preparation Assistance

In 2014, the IRS stopped providing free return preparation services at local Taxpayer Assistance Centers. Taxpayers are now directed to use Free File tax preparation software or obtain assistance from Volunteer Income Tax Assistance (VITA) sites or Tax Counseling for the Elderly (TCE) sites. However, the National Taxpayer Advocate reports that VITA and TCE sites are inadequately funded and are unable to meet the influx of demand.

Question: What is the IRS doing to assist taxpayers that are not being captured by VITA or TCE sites due to limited resources?

Response: In December 2007, Congress first appropriated funds to the IRS to establish and administer a matching grant program for community volunteer income tax assistance. Each year since, Congress has appropriated annual funding for the program. For filing season 2015, Congress appropriated \$19 million for the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs, which was an increase over the \$17.6 million in 2014.

We leverage these national and local partners to deliver free tax preparation and outreach programs to millions of taxpayers throughout the nation at over 12,000 sites. As of April 19, 2015, over 90,000 volunteers prepared more than 3.6 million federal tax returns, compared to 3.5 million returns the same time last year (an increase of 100,000 returns). In comparison, in 2013, the last year the IRS prepared returns in TACs, the IRS completed only 65,000 returns.

For taxpayers who do not have access to VITA or TCE sites, IRS has a variety of services available on irs.gov and those provided by our partner organizations. Taxpayers are encouraged to take advantage of the many resources available 24/7 on [IRS.gov](http://irs.gov). These resources include online forms and publications, tax law interactive tools and references, Where's my Refund?, Direct Pay, Online Payment Agreement, and Understanding Your IRS Notice or Letter. These resources are all available any time on [IRS.gov](http://irs.gov). Those without internet access can use their telephone to access toll-free automated response systems that provide recorded information on a variety of tax topics. We also created the IRS Services Guide to help taxpayers and practitioners locate the services they need (<http://www.irs.gov/pub/irs-pdf/p5136.pdf>). Taxpayers also have the option to use Free File and Free File Fillable Forms to prepare their return at no cost. Taxpayers can choose from a variety of online software options based on the taxpayer's adjusted gross income. For the future, we intend to build toward a new approach that centers on

improving online help to taxpayers, who increasingly demand these types of service, while at the same time taking steps to safeguard taxpayer information and prevent identity theft and fraud.

Although initial indications are that return processing went smoothly, our level of customer service this filing season has been unacceptably low, both in person and on the phone, despite the best efforts of our employees.

Our low service levels were the result of the budget cuts we have had to absorb and spending to deliver on legislative mandates. Funding for the agency has been reduced by \$1.2 billion over the last five years, dropping to \$10.9 billion in Fiscal Year (FY) 2015. The IRS is now at its lowest level of funding since 2008. If adjusted for inflation, the agency's budget is now comparable to where it was in 1998, except that this year we will process an estimated 27 million more returns than we did 17 years ago.

Maintaining the integrity of the nation's tax system requires a balance between taxpayer service and enforcement as both have an impact on taxpayer behavior.

With seventy-five percent of our budget being personnel, and one-third of our workforce providing taxpayer service, the continuing cuts to our budget have severely hampered our ability to provide taxpayers with the services they need and deserve.

Tax Gap

According to the IRS's budget request, our "tax gap," or the difference between taxes owed and taxes paid, was estimated to be \$385 billion in 2006.

Question: What is the IRS doing to close this gap and by your estimates, how much additional revenue would the IRS be able to collect if the agency is fully funded?

Response: Addressing the tax noncompliance reflected in the tax gap estimates requires a broad based strategy that both facilitates and fosters improvements in voluntary compliance and provides for effective detection, correction, and enforcement, as appropriate, when voluntary compliance on the part of taxpayers is not realized. Large increases in compliance would require additional resources and effort on the part of the entire tax community—taxpayers, preparers, and the IRS and consideration must be given to the benefits and costs to achieving extremely high levels of tax compliance. The IRS's efforts to sustain and improve compliance and address the tax gap involve a broad set of activities.

Failures to comply with tax law can involve unintentional mistakes that are the result of not fully understanding what has become an extremely complex tax code. For that reason, efforts to increase tax compliance must also include programs to educate taxpayers in their tax obligations, along with efforts to improve taxpayer service, to make it easier for individuals and businesses to fulfill their tax responsibility.

Despite the many challenges, the IRS has been and continues to be committed to finding ways of improving tax compliance, particularly voluntary compliance, which is the cornerstone of our tax system. From a revenue standpoint, the importance of voluntary compliance cannot be overstated: Each additional percentage point of voluntary compliance established brings in about \$30 billion in tax receipts. Therefore, any loss of public confidence in the proficiency and fairness of the IRS, which reduces voluntary compliance, would come at a high cost, and the effects of a reduction in voluntary compliance would take a long time to reverse.

Achieving greater voluntary compliance involves a comprehensive, integrated long-term strategy. Along with increased enforcement activities which enhance confidence and fairness in the tax system, a comprehensive strategy must also include: expanding compliance research; improving information technology; reforming and simplifying the tax law; coordinating with states, foreign governments, and other partners and stakeholders to share information; and, as noted above, enhancing taxpayer service.

The IRS's program for implementing legislation on merchant card reporting is a good example of our recent efforts to address the \$122-billion portion of the tax gap that represents underreporting of business income by individuals. This program involves requiring payment settlement entities to send us information on Form 1099-K.

Congress enacted the reporting requirement because lawmakers understood that cash and credit card transactions underlie much of the income underreporting by small businesses. Bad actors who wanted to gain an unfair advantage over law-abiding taxpayers could do so simply by not reporting all of their transactions. Therefore, in addition to helping improve tax compliance, the Form 1099-K reporting regime also helps level the playing field for small businesses.

The challenge for the IRS is determining how to properly use the data gleaned from the Form 1099-K, as reported income is generally a mix of credit card and cash receipts. The IRS has found the Form 1099-K allows us to compare similar businesses, spot anomalies, and follow up with businesses to determine why those anomalies exist. In fact, we are already beginning to notice an impact from this new reporting regime.

The IRS has worked to use the information received from the Form 1099-K while minimizing the burden on small businesses by seeking input from the business community on this program and by giving taxpayers extra opportunities to respond, fix errors, or explain their situation. In fact, most taxpayers contacted by the IRS have responded to our notices, and have taken the opportunity to explain unusual circumstances or correct errors, often without an audit. It is important to note that about 60 percent of taxpayers we contacted about potential underreporting of 2011 income increased the amount of income reported in 2012.

Another good example of our recent work to increase tax compliance involves the international tax area in general, and offshore tax avoidance in particular. The IRS has made great strides over the last several years both in finding tax evaders hiding assets overseas and assessing and collecting tax liabilities. The IRS has also encouraged taxpayers to voluntarily disclose their foreign accounts and pay the amount they owe.

The IRS has conducted thousands of offshore-related audits that have produced tens of millions of dollars and, where appropriate, has pursued criminal charges leading to billions of dollars in criminal fees and restitution. Taxpayers have also been given the opportunity to come forward and accurately report their tax liabilities. Since its establishment in 2009, the Offshore Voluntary Disclosure Program (OVDP) has resulted in more than 50,000 disclosures of underpaid or unpaid taxes and the collection of more than \$7 billion in back taxes, interest and penalties.

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The IRS' budget situation represents a very serious challenge to our ability to continue making progress on this front. The President's 2016 Budget provides \$12.3 billion in base discretionary resources, including strategic investments to continue modernizing our systems, improve service to taxpayers, and reduce the deficit through more effective enforcement and administration of tax laws. The Budget also proposes a \$667 million cap adjustment to support program integrity efforts aimed at restoring enforcement of current tax laws to acceptable levels and to help reduce the tax gap. This multi-year effort is expected to generate \$60 billion in additional revenue over the next ten years at a cost of \$19 billion. If enacted and fully funded, this is estimated to reduce the deficit by \$41 billion.

IRS Service Quality

According to a recent report from the National Taxpayer Advocate, the most serious problem encountered by taxpayers is the declining quality of service provided to them when they try and

comply with tax filing and payment obligations. For instance, in 2004, the IRS had a call response rate of 87 percent and hold times averaged two and a half minutes. So far this year, however, response rates have been 43 percent and hold times are averaging almost 30 minutes. I find this very alarming.

Question: I understand that the IRS has asked for increased funding in their budget request and I notice that the agency has been hit especially hard over the past few years. However, could you please expand on IRS efforts to improve taxpayer service, in lieu of increased funding?

Response: In 2014, the IRS began prioritizing limited staffing and resources to help those taxpayers who must interact with us by phone or in person, while encouraging those who do not require these types of services to use self-service or other, more efficient options. More specifically, we are leveraging irs.gov to deliver more services on-line; as well as those provided by our partner organizations, to reach the greatest number of taxpayers – far more than could have been helped on a one-to-one basis over the phone or in-person at Taxpayer Assistance Centers. Efficient use of these options allows us to focus our limited ability to provide live assistance to those cases where direct assistance is the only option.

Even within our budget constraints, we've already made some significant improvements in our technology to serve taxpayers. For example, one of the most popular features on IRS.gov is the "Where's My Refund?" electronic tracking tool. As of May 23, 2015, taxpayers have already used it more than 217 million times this year, up approximately 24% over last year.

Through our public-private partnership with the Free File Alliance, approximately 70% of all taxpayers qualify to use brand-name software to prepare and file their tax returns for free, and all individual taxpayers qualify to use our Free File Fillable Forms regardless of income. In addition, we partner with thousands of external groups to provide seniors and low to moderate income taxpayers the option to get free help with return preparation through our Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs. As of April 19, 2015, over 90,000 volunteers prepared more than 3.6 million federal tax returns at 12,000 Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites.

We will continue to seek improvements and look for new and efficient ways to serve all taxpayers, while at the same time taking steps to safeguard taxpayer information and prevent identity theft fraud.

WEDNESDAY, MARCH 4, 2015.

DEPARTMENT OF THE TREASURY

WITNESS

HON. JACOB J. LEW, SECRETARY, DEPARTMENT OF THE TREASURY

Mr. CRENSHAW. The hearing will come to order. We are going to vote pretty soon, but let's start the hearing.

Good afternoon to everyone. The subcommittee today welcomes the Secretary of the Department of Treasury, Jack Lew, here to discuss the President's fiscal year 2016 budget request, as well as the Department's budget request.

The request was submitted on the first Monday in February, in accordance with the Congressional Budget Act, for the first time since 2010. While timeliness is appreciated, a budget that spends more, taxes more, and borrows more is not.

At its peak in fiscal year 2009, the deficit was a record-setting \$1.4 trillion, or nearly 10 percent of the GDP. The deficit declined in fiscal year 2014 to \$485 billion, which is a reduction of \$928 billion. But only the most superficial analysis would lead anyone to believe that this is a credible policy accomplishment by the Administration because, as we know, the deficit is the difference between spending—or outlays, as we like to call it—and revenue. When you look closely at what accounts for recent deficit reduction, you will find that increased revenue accounts for about 99 percent of that \$928 billion deficit reduction, whereas decreased outlays are only about 1 percent of that.

And if you look more closely at the decreased outlays, all of it is attributable to the discretionary side of the government's ledger. And so in fiscal year 2009 through 2014 discretionary spending decreased, actually went down by \$58.8 billion, but mandatory spending increased by \$47.3 billion. So that means that all of the spending restraint for the past 5 years is the result of the hard work of the Appropriations Committee under the leadership of our able full committee chairman, Hal Rogers.

Nonetheless, even as the deficit has declined, total public debt outstanding has grown to a record high of more than \$18 trillion. The demographic changes underway in this country mean that benefits like Social Security, Medicare, Medicaid enjoyed today, are going to be bills that are paid tomorrow by our children and our grandchildren. And, regrettably, the President's budget does not address the unavoidable question of how to distribute the economic cost of an aging population across generations.

So because of this, Mr. Secretary, I urge you to work with the Budget Committees and the authorizing committees to help lift the yoke off the back of the younger generations of hard-working Americans.

Now, the Treasury Department's budget request for this year is strikingly similar to last year, with the exception of the IRS. Instead of the \$1 billion increase, the Department is now requesting a \$2 billion increase for the IRS. And you might remember I described last year's request as troublesome, but now that it is a \$2 billion request, I would say it is even more troubling.

We are going to have a separate hearing on the IRS, and Commissioner Koskinen will come before the committee, and I think we have made it clear that the IRS has betrayed the trust of the American people. I think they would agree with that. We talked about their need to restore that trust, to earn back that trust. We want to see that happen.

But in spite of that, the request from the IRS this time seeks to pay certain IRS employees salaries and bonuses that are bigger than what is allowable under the civil service system. The request also eliminates some of the requirements that we put in our bill, such as prohibiting the IRS from targeting. That is gone. Reviewing the appropriateness of IRS videos. That is gone. Compliance with the Federal Records Act. That is gone. Guarding against excessive conferences spending. That is gone. Upholding the confidentiality of tax returns. That is not there anymore.

To me, these are commonsense, good government reforms that help heal some of the IRS' self-inflicted wounds. More reforms, however, may be necessary if the incorrect information sent to about 800,000 low-to-moderate-income households foreshadows yet even more difficulties with the administration of the Affordable Care Act.

I am also troubled by the Department's desire to cut funding for the Office of Terrorism and Financial Intelligence. It seems particularly ill-conceived when we are trying to deal with ISIL. We want to cut off funding for that terrorist group. We think that that ought to be a priority. Monitoring the Iranian economy and financial transactions will be necessary with or without the final nuclear deal and we might need additional economic pressure on Russia if the Ukraine ceasefire doesn't hold up.

The Administration's decision to normalize relations with Cuba, that is causing some concern, especially with regard to the increased people-to-people travel and the trafficking of confiscated properties. That is something we are going to follow closely and carefully.

But still I want to hear, Secretary Lew, what you think are the most important aspects of the President's budget and the Department's budget because I am hopeful we can find some common ground to work together.

In addition, I am interested in hearing a little bit about the Financial Stability Oversight Council, the so-called FSOC. They have adopted some guidance that attempts to improve the transparency with regard to entities under consideration for the so-called SIFI designation, Systemically Important Financial Institutions.

Now, I think that the transparency step is one in the right direction, but the FSOC's actions, as I understand it, don't really address some of the concerns about how it will mitigate systemic risk. I question why the FSOC would not create a process to allow companies, or primary regulators—why wouldn't you let them address

the identified risks before designation? It seems to me that would save a lot of time and a lot of resources for the Council, as well as allow everybody to enjoy, and maybe ensure, more economic stability.

And so before you move into your testimony, let me just say one thing about what is going on today in the Supreme Court. As we all know, they were having oral arguments about *King v. Burwell*, and that case has the potential to outlaw subsidies that are inherent in the Affordable Care Act for millions of Americans who enrolled in the health coverage through the Federal exchanges. And if you recall, the Treasury Department was unprepared under an earlier decision, it was called *Loving v. IRS*, that determined that the IRS didn't have any authority to regulate paid tax preparers.

King v. Burwell is a lot more consequential and a lot more complicated than *Loving v. IRS*. And so I hope that the Treasury has a contingency plan in the event of a ruling in *King v. Burwell* that outlaws subsidies. So I would love to hear if you have any thoughts about how you are going to prevent these millions of Americans from entering a prolonged period of uncertainty surrounding their health care and tax liability if *King v. Burwell* is decided for the plaintiffs.

These are ordinary and customary questions that any prudent organization would undertake to manage their legal risk, no different than the contingency plans that Treasury, FSOC, and other financial regulators are asking from the private sector for all sorts of possibilities.

And last thing, Mr. Secretary, I just want to take a minute to highlight some landmark legislation that was signed into law late last year. It was called the Achieving a Better Life Experience Act, or the ABLE Act. What that did was create 529 savings accounts for people with disabilities. It actually levels the playing field for millions of Americans who are going to be allowed to use tax-free savings accounts for certain expenses, just like they can save money for retirement or save money to go to college.

And as you may know, the States are responsible for administering the program, but the Department needs to issue regulations. And I am hopeful that the Department will meet that statutory requirement and hopefully the States can move as quickly as possible, because there are millions of Americans that are going to have a door open to a brighter future.

So, again, let me thank you for taking the time to be here today. I look forward to hearing your testimony.

And now let me turn to the ranking member, Mr. Serrano, for an opening statement.

Mr. SERRANO. Thank you, Mr. Chairman. I would like to join you in once again welcoming Secretary Lew before the subcommittee to discuss the Department's budget for fiscal year 2016.

The Treasury Department is at the center of our economic recovery plan, plays an important role in the implementation of some of our most important public policy initiatives, like the Affordable Care Act and Dodd-Frank, manages our Nation's finances, and works to enforce our tax laws fairly. I have not mentioned everything, but it is plain to see that this is a diverse set of responsibilities.

Your budget request attempts to improve funding levels for many parts of your work, but let me highlight just a few. First and foremost, your budget attempts to restore the devastating budget cuts that hit the IRS in fiscal year 2015. The IRS estimates that the \$346 million in cuts suffered last year will result in \$2 billion less in revenue collected and in fewer services to honest taxpayers trying to get their questions answered by the IRS. In other words, we are increasing the tax gap and making things more confusing for taxpayers.

Regardless of your feelings regarding the handling of the IRS' problems, this is not a recipe for success. We cannot keep pretending that less investment in the IRS is somehow going to increase compliance and lower the tax gap. That is why I applaud your efforts to restore IRS funding to more sustainable and effective levels.

Additionally, you request a modest increase for the Community Development Financial Institutions Fund. The CDFI Fund has helped invest hundreds of millions of federal dollars in my congressional district since its creation 20 years ago, and it has been an important driver of economic development in my district, in the Bronx, and in other underserved communities. Although I am concerned the Department has once again recommended the elimination of the BEA program, I am heartened that we all agree about the importance of the work that the CDFI Fund does every day.

Lastly, I would be remiss if I did not mention the Department's important role in implementing the President's groundbreaking change to our ineffective Cuba policies. I look forward to working with you and with the Office of Foreign Assets Control to make sure that there are no problems with the implementation of these efforts.

Secretary Lew, I know that this change in Cuba policy is historic. Some of us thought it would never happen. It entails a lot of changes and a lot of great possibilities for both of our countries, and we will be working with you to make sure this goes as smoothly and possible. And I thank you for your being here today.

Mr. CRENSHAW. Thank you.

And now I would like to turn to the ranking member of the full committee, my good friend Nita Lowey, for her opening statement.

Mrs. LOWEY. Well, thank you very much, Chairman Crenshaw and Ranking Member Serrano for holding this hearing.

And to my friend Secretary Lew, thank you for joining us today.

Mr. Secretary, your fiscal 2016 budget requests \$14.3 billion for the Department of the Treasury's operating bureaus and \$2.9 billion for international programs, which is covered by the Subcommittee on State and Foreign Operations. As you have noted, the President's budget would achieve \$1.8 trillion of deficit reduction over 10 years, primarily from reforms to our health, tax, and immigration systems. If it were adopted, deficits would continue to decline to about 2.5 percent of GDP over the 10-year budget window, which is down 75 percent from a peak of 9.8 percent. And we added more jobs in 2014 than in any year since the late 1990s. And yet, we can and must do more to continue to provide access to capital and get people back to work.

In other hearings some of my friends on the other side of the aisle have stated their opposition to many of the revenue portions of the budget request. While I believe Congress should closely scrutinize and shape the final product, I would point out the constraints that our committee has operated under. Even excluding sequestration, Congress has passed and President Obama has signed into law more than \$2.5 trillion in deficit reduction, \$1.5 trillion of which has come from discretionary spending cuts. In fact, discretionary investments are on a path to be at their lowest level as a share of GDP since the Eisenhower administration.

I ask my friends on the other side of the aisle, after this committee has cut so much, are you really unwilling to close tax loopholes in order to invest more in transportation infrastructure, education, job training, biomedical research and other R&D efforts, and the military as well?

Thank you very much.

Mr. CRENSHAW. Thank you.

Mr. Secretary, they have called a vote. There are 11 minutes left. There is plenty of time if you would like to take a few minutes to make an opening statement. We would be happy to hear that. And then we might take a brief recess and come back. But, please, the floor is yours, as long as you don't go more than 5 minutes.

Secretary LEW. Well, thank you, Mr. Chairman. I would ask that you include my complete testimony in the record. In the interest of time, I would be happy to dispense with my opening remarks and take questions right away since I know, with the votes coming, it may be challenging for some members to come back.

[The information follows:]

FY 2016 Treasury Budget Testimony

March 4, 2015

Chairman Crenshaw, Ranking Member Serrano, members of the Subcommittee, thank you for giving me the opportunity to appear before you today to discuss Treasury's Fiscal Year 2016 Budget.

As we meet here this morning, our economy and our country have made considerable progress that we can all take pride in. By almost every metric—from job creation, economic growth, and deficit reduction to manufacturing, exports, and energy independence—America has come a long way. The fact is, in 2014, we saw the best year of job growth since the 1990s, and over the past five years, America's businesses have created nearly 12 million new jobs—the longest stretch of sustained private sector job growth in our nation's history. Our economy continues to expand, with healthy growth in 2014 and forecasts projecting above-trend growth for this year. We continue to outperform our trading partners, many of which are still struggling to recover from the global economic crisis. American exports set another record last year for goods and services sold overseas, and this record was largely driven by small businesses. And our deficit, which has fallen by almost three-quarters, is forecast to decline even further in the next fiscal year.

These achievements underscore America's enduring economic strength, and the continued progress we can make with the right policies and bipartisan cooperation. The President's budget is a blueprint for Washington to work together. It not only lays out a path to find common ground, it puts forward sensible solutions to make sure every American who works hard has a chance to get ahead.

This budget knocks down barriers for working families so things like child care, mortgage payments, and a college education are more affordable. It modernizes our job training system, fuels research and development, and repairs our roads, bridges, and ports so more companies will invest, locate, and hire in the United States. And it reforms our tax system so we can eliminate special-interest loopholes, strengthen the middle class, and level the playing field for businesses.

At the end of 2013, policymakers came together on a bipartisan basis to partially reverse sequestration and to pay for higher discretionary funding levels with long-term reforms. We have seen the positive consequences of that bipartisan agreement for our ability to invest in areas ranging from research and manufacturing to strengthening our military. We have also seen the positive consequences for the economy, with an end to mindless austerity and manufactured crises contributing to the fastest job growth since the late 1990s. The President's Budget builds on this progress by reversing sequestration, paid for with a balanced mix of commonsense spending cuts and tax loophole closers, while also proposing additional deficit reduction that would put debt on a downward path as a share of the economy.

Meanwhile, the President has made clear that he will not accept a budget that reverses our progress by locking in sequestration going forward. Locking in sequestration would bring real defense and non-defense funding to the lowest levels in a decade. As the Joint Chiefs and others have outlined, that would damage our national security, ultimately resulting in a military that is too small and equipment that is too old to fully implement the defense strategy. It would also

damage our economy, preventing us from making pro-growth investments in areas ranging from basic research to early childhood education and our nation's infrastructure. As the President has stated, he will not accept a budget that severs the vital link between our national and economic security, both of which are important to the Nation's safety, international standing, and long-term prosperity.

As part of the President's approach, Treasury's budget request will allow the department to carry out its vast responsibilities efficiently and effectively. Treasury plays a key role in shaping and implementing the President's economic policies. Today's request will allow the department to promote economic prosperity, fiscal responsibility, and a resilient financial system even as it advances our national security objectives and bolsters stability at home and abroad. The Treasury Department touches the lives of nearly every American through our work to responsibly manage the government's finances, streamline and reform the tax system, fuel lending to small businesses, spur economic development in struggling communities, advance our strategic interests, make Social Security payments, and produce and modernize our nation's currency.

Since President Obama took office, the Treasury Department has had to marshal its resources to confront deep domestic and global challenges, and we have consistently met our obligations efficiently and at the lowest cost to the taxpayer. Treasury's Fiscal Year 2016 budget continues to achieve savings and fund vital programs alongside strategies that will make the department more effective. The request includes strategic investments in improved taxpayer services, enforcement, and technology at the Internal Revenue Service (IRS); funding for select high priorities such as implementing the Digital Accountability and Transparency Act of 2014; and increasing the availability of healthy food options for low-income communities via the Healthy Food Financing Initiative.

Investing in a high-performing Internal Revenue Service

Despite the IRS's critical role of collecting more than 90 percent of the federal revenue, Congress has continually reduced funding for the agency over the last five years by a total of \$1.2 billion or 10 percent. A sustained deterioration in taxpayer services combined with reduced enforcement activity could create serious long-term risk for the U.S. tax system, which is based on voluntary compliance.

The Fiscal Year 2016 Treasury Budget includes a \$1.3 billion increase within the discretionary caps to begin restoring taxpayer services to acceptable levels. Funds are also included to continue major IT projects, which aim to protect taxpayer information, modernize antiquated systems, continue development of a state-of-the-art online taxpayer experience, and build efficiencies throughout the agency. Finally, funds are included for initiatives that are critical to full and effective IRS implementation of legislative mandates including the Affordable Care Act and the Foreign Account Tax Compliance Act.

In addition, the Budget includes \$667 million -- financed by a proposed program integrity cap adjustment for enforcement initiatives -- that provide a high return on investment. This proposed cap adjustment funds strategic investments that will help close the tax gap and return

\$6 for every dollar invested, once fully implemented in Fiscal Year 2018. This multi-year effort is expected to generate \$60 billion in additional enforcement revenue at a cost of \$19 billion, thereby reducing the deficit by \$41 billion over the next ten years.

Treasury's request includes substantial investments to help strengthen taxpayer services and to adequately fund tax enforcement to make sure all taxpayers play by the same rules.

Increasing transparency in federal financial management

The Treasury Budget also includes funding for efforts to increase transparency and accountability in federal financial management and to implement the Digital Accountability and Transparency Act of 2014 (DATA Act). The DATA Act requires additional federal spending data to appear on USAspending.gov as well as the establishment of government-wide financial data standards for any federal funds made available to or expended by federal agencies and entities receiving these funds.

Strengthening the economy and creating job opportunities

The Treasury Budget request makes key investments that will help spur economic growth and job creation and increase financial access and capability for local communities and small businesses, while boosting confidence in the safety and soundness of the U.S. financial system.

Our request includes \$233.5 million for the Community Development Financial Institutions (CDFI) Fund, which promotes economic development investments in low-income communities. The Budget proposes to extend the CDFI Bond Guarantee program through Fiscal Year 2017, to provide a source of long-term capital to financial institutions that support lending in underserved communities. Of the total request, \$35 million for the Healthy Food Financing Initiative will support the growth of businesses that improve the availability of affordable, healthy food options in low-income communities.

The Treasury Budget also supports small business growth through reauthorization of the State Small Business Credit Initiative (SSBCI). From Fiscal Year 2011 to Fiscal Year 2013, SSBCI programs in all 50 states supported over \$4.1 billion in loans and investments to 8,500 small businesses across the country — creating or saving more than 95,000 American jobs. To continue our support for state economic development agencies' work to boost lending to small businesses, the Budget proposes a new investment of \$1.5 billion for SSBCI. This additional funding would be awarded in two allocations, with \$1 billion awarded on a competitive basis to states best able to target local market needs, promote inclusion, attract private capital for start-up and scale-up businesses, strengthen regional entrepreneurial ecosystems, and evaluate results. An additional \$500 million will be allocated to states according to a need-based formula. A new authorization of the SSBCI program will keep local economic development efforts strong and allow states to continue to support small businesses, job creation, and leverage greater levels of private lending and investments.

Treasury also proposes an authorization of \$300 million for Pay for Success projects that demonstrate measurable outcomes, resulting in greater federal savings and programmatic efficiency.

Protecting national security interests and preventing illicit use of the financial system

Treasury's financial intelligence, sanctions policy, and enforcement activities play a significant role in protecting our financial system from threats to our national security.

The Budget proposes \$109.3 million for the Office of Terrorism and Financial Intelligence (TFI) to oversee and marshal Treasury's intelligence, enforcement, and economic sanctions functions in support of U.S. national security policies and interests. Our funding request reflects Treasury's continued efforts to combat rogue nations, terrorist facilitators, money laundering, drug trafficking, and other crime as well as other threats to our nation's security. These efforts include disrupting the Islamic State of Iraq and the Levant's (ISIL) finances, enforcing sanctions against Iran, implementing sanctions against Russia in support of Ukraine's stability, and enhancing global financial transparency.

Treasury's request also includes \$113 million for the Financial Crimes Enforcement Network (FinCEN) to support Treasury's efforts to safeguard the financial system from illicit use, combat money laundering, and support national security interests through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.

Supporting international assistance programs

Finally, while not under this subcommittee's jurisdiction, I also want to note that Treasury's request on its International Programs aims to promote our national security, open new markets for U.S. exporters, and address global challenges such as food insecurity, the environment, and poverty. Treasury proposes to increase the U.S. quota in the International Monetary Fund (IMF) and simultaneously reduce, by an equal amount, U.S. participation in the IMF's New Arrangements to Borrow. The Administration believes that a strong and well-resourced IMF is in the U.S. vital interests. Our priority has been and remains to secure Congressional support as soon as possible to implement the 2010 reforms. The immediate ratification of these reforms is essential to modernizing the IMF's governance and bolstering its ability to respond to urgent international crises — and will preserve the United States' influence in the institution without increasing our financial commitment. Failure to ratify will hurt our national security both today and in the future.

Furthering Wall Street Reform, Consumer Protection and Financial Stability

Reforms like increased capital standards and limits on excessively risky practices, among others, are transforming the way Wall Street operates, strengthening our financial system and making it more resilient. In the coming year, Treasury will continue to work with the federal agencies to finalize efforts in areas such as compensation reform. Likewise, through the Financial Stability Oversight Council, we will continue to work across the member agencies to assess risks to financial stability and work to mitigate them where needed. Going forward, we must remain vigilant to potential new threats to the stability of the financial system, constantly monitoring how risks change and evolve.

Conclusion

The Fiscal Year 2016 Treasury Budget reflects key investments needed to create economic and job opportunities, protect our national security interests, and the integrity of the financial system, and manage and reform the U.S. government's federal financial management and tax systems.

The Treasury Budget plays an important role in the President's Budget, which aims to bring middle class economics into the 21st Century. It is carefully designed to make our economy stronger while maintaining a responsible fiscal course. What is more, it is an opportunity for bipartisan cooperation to achieve meaningful reform that will help hard-working Americans share in our economic gains.

In closing, I want to thank the talented team of public servants at the Treasury Department. They are dedicated to the work of the department and committed to the American people. I am proud to represent them here today, and on behalf of these hard-working men and women, I want to say how much we appreciate the support of this Committee.

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

Jacob J. Lew, Secretary of the Treasury

Jack Lew was confirmed by the United States Senate on February 27, 2013, to serve as the 76th Secretary of the Treasury. Secretary Lew previously served as White House Chief of Staff. Prior to that role, Lew was the Director of the Office of Management and Budget (OMB), a position he also held in President Clinton's Cabinet from 1998 to 2001. Before returning to OMB in 2010, Lew first joined the Obama Administration as Deputy Secretary of State for Management and Resources.

Before joining the State Department, Lew served as managing director and chief operating officer for two different Citigroup business units. Prior to that, he was executive vice president and chief operating officer of New York University, where he was responsible for budget, finance, and operations, and served as a professor of public administration. From 2004 through 2008, Lew served on the Board of Directors of the Corporation for National and Community Service and chaired its Management, Administration, and Governance Committee.

As OMB Director from 1998 to 2001, Lew led the Administration budget team and served as a member of the National Security Council. During his tenure at OMB, the U.S. budget operated at a surplus for three consecutive years. Earlier, Lew served as OMB's Deputy Director and was a member of the negotiating team that reached a bipartisan agreement to balance the budget. As Special Assistant to President Clinton from 1993 to 1994, Mr. Lew helped design Americorps, the national service program.

Lew began his career in Washington in 1973 as a legislative aide. From 1979 to 1987, he was a principal domestic policy advisor to House Speaker Thomas P. O'Neill, Jr, when he served the House Democratic Steering and Policy Committee as Assistant Director and then Executive Director. He was the Speaker's liaison to the Greenspan Commission, which negotiated a bipartisan solution to extend the solvency of Social Security in 1983, and he was responsible for domestic and economic issues, including Medicare, budget, tax, trade, appropriations, and energy issues.

Before joining the Obama Administration, Lew co-chaired the Advisory Board for City Year New York and was on the boards of the Kaiser Family Foundation, the Center on Budget and Policy Priorities, the Brookings Institution Hamilton Project, and the Tobin Project. He is a member of the Council on Foreign Relations, the National Academy of Social Insurance, and of the bar in Massachusetts and the District of Columbia.

Mr. CRENSHAW. If that is okay with you. Let me ask one question, and then I think with 5 minutes to go, since we have a series, we will all probably have to get up and leave, but I think it will take less than 30 minutes.

SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

Let me just ask you about the Financial Stability Oversight Council that we talk a lot about, the FSOC. You remember last year I asked you some questions because you are the chairman of the FSOC, and it seems to me just over this last year that more confusion has been added. A lot of people are trying to do the right thing, but they don't know exactly where they stand. The question of transparency, especially, has been raised.

FSOC ought to bring stability to the financial markets, but it seems to be working the other way. And I have told you and I have told SEC Chair White that I think the individual regulatory agencies are actually better equipped than FSOC to handle some of these things.

But, for instance, if the primary focus is to identify and ensure systemic risks are adequately and appropriately addressed, wouldn't that be better than just designating SIFIs, and do you give companies the ability to address some of those systemic concerns before they get designated as a SIFI? And if not, why don't you do that?

And finally, tell me why it is better to have this new Council as opposed to an agency that was set up, like the SEC, to address those kind of risks. Just touch on that about how the FSOC is actually working out.

Secretary LEW. Mr. Chairman, let me start by saying that I think if you look at our financial system today and compare it to the time before the financial crisis, it is a lot safer than it was and there is a lot more protection for our economy and for the American people than there was before. So I think the steps that have been taken have done an awful lot to reduce the level of risk.

With regard to why FSOC and not regulators, before the financial crisis there was no regulatory agency that had responsibility to look across the economy and ask the question, is there systemic risk that needs to be addressed? Each had its own siloed set of responsibilities. No one had responsibility for the crosscutting question of systemic stability to be the driving question. FSOC was created to bring the regulators together and have a place where those questions could be asked across the entire financial system.

The authority to designate a financial institution is really based in the statute on finding that there is a level of systemic risk. It does not say you can do things to prevent it. It says if you find that there is systemic risk, the act that FSOC takes is designation, and then there is a regulatory procedure that follows.

In many cases, what FSOC looks at outside of the designation process are issues that go back to the regulators with primary jurisdiction. So, for example, on money market funds, FSOC has looked at that issue, but it went back to the SEC for rulemaking action. In the case of designations, that is one authority that FSOC as a body across government, across regulators, takes when the finding of systemic risk is made.

Mr. CRENSHAW. Just on that point, do you think that the SIFI designation, is that appropriate for non-bank entities?

Secretary LEW. You know, I think that the question really has to go back to does the entity present a level of risk that warrants the designation. That gets to a question of the structure of the financial activities, the interconnectedness of the entity with other financial entities and individuals, and what the flow of risk would be if there were to be a failure of the entity.

Obviously, since we have designated a variety of different kinds of actors, it is more than just traditional financial institutions. We have market utilities that have been designated and we have several insurance companies that have been designated.

You know, I do not think that we view it as kind of a general directive to look at corporations, businesses, activities that don't have to do with the financial system. So there would have to be that connection to the financial system, but the kind of entity, obviously, has varied.

Mr. CRENSHAW. But, for instance, if you get designated a SIFI, that can be costly. And if you designate, for example, an asset manager or a mutual fund, then they will have costs involved and they will pass those on to their investors. And a lot of those are people that are just saving for college or saving for retirement.

And under Dodd-Frank, these nonbank SIFIs, they can be assessed to help pay for the resolution of the failing financial institutions, banks, that is what we think of. So you have got these provisions, but when you designate an entity such as a mutual fund as a SIFI, then that means these fund investors, they might be on the hook for bailing out the banks who, I guess, were the bad actors in that case.

So, is that something you all have thought about when you designate a nonbank as a SIFI? Some investors impacted might be average Americans who are relying on their investments and they might end up on the hook to pay for some bad actions of a bad bank.

Secretary LEW. You know, the purpose of FSOC, the purpose of financial reform is to protect individuals from the kinds of instability that come when you have a financial crisis like 2008. In 2008, there were a lot of people who saved for college and their retirement who saw their savings just evaporate because of the financial crisis. So the goal is to see where there is systemic risk and address it.

I do not want to say who is and is not going to present that kind of risk, because one of the things I think FSOC has done very well is it has looked at every matter as a case-by-case review with a very diligent process where there has been back and forth with the company. We have now, as you noted, adopted some new rules to increase the level of engagement with companies earlier on in the process.

I think that those findings will determine where designations are appropriate. We should not have a rule going in of what we will and we will not do. What I am committed to is making sure that the FSOC is always fact- and analytically-driven, that it be driven by where are the risks of the future, not the risks of the past. Our job is to make sure we can tell those savers that we are doing ev-

everything we can to make sure that the financial system is safe and sound.

Mr. CRENSHAW. Thank you. I just hope you keep in mind the costs and benefits of these designations.

There are a couple of minutes left. I think it would be good to recess now. There is one amendment, a motion to recommit, and final passage. Should be less than 30 minutes. I know the members have a lot of questions, and I appreciate you working with us. So let's stand in recess. And come back as fast as you can.

[Recess.]

Mr. CRENSHAW. We will reconvene the hearing now. And I would like to recognize Ranking Member Mr. Serrano for questions.

IRS BUDGET CUTS

Mr. SERRANO. Secretary Lew, before we move to your fiscal year 2016 request, I would like to revisit momentarily 2014 and 2015 with you. Specifically, I would like you to speak about the impact of the deep cuts in the IRS budget. When inflation is taken into account, the IRS is now down to 1998 levels. What are the short- and long-term ramifications of continuing to reduce the ability of the IRS to accurately and efficiently collect tax revenues?

Secretary LEW. Congressman, the funding levels at the IRS are very troublesome. It ranges from not being able to do the basic things, like answering taxpayer calls, putting them on hold for so long that they drop, to not having the resources to put into properly enforcing our tax laws. In a system like ours, which is based on voluntarily compliance, it is a dangerous practice to underfund enforcement for a long period of time. It is very corrosive. It loses money. It loses billions of dollars to underfund the IRS.

I must say that I am proud of the team at the IRS. The career staff at the IRS do an extraordinary job under very difficult circumstances. The inconveniences to taxpayers are being mitigated because IRS has been effective at using Web-based information systems to provide information and to be able to respond to questions to reduce the call volume. But we cannot count on that forever. At some point you need to get a human being on the other end of the phone.

I think in the world of technology we have old systems, which if we do not continue to improve them will become more and more difficult to just operate normally. But they also become more and more vulnerable to the kinds of threats that we face in cyberspace nowadays.

So I think the underfunding of the IRS is shortsighted and damaging to one of the important institutions of any democracy, which is the organization that is responsible for making sure we collect our taxes from people who legally owe them and do it in a way that provides customer service that American taxpayers deserve.

Mr. SERRANO. Yeah, well, let me just go on the record once again as saying that I agree with you, and I have agreed with people in the past who have said the same or similar things to what you just said.

You know, there are some cuts you don't like, some cuts you don't like and you know they make no sense. These cuts make no

sense because eventually we hurt ourselves. We are supposed to be collecting more money, not breaking it down so you can't collect.

CUBA

Let me move on to one of my favorite subjects, one that I am very pleased with, the new regulations and the attempt at a new relationship with Cuba. Without telling me anything about secret negotiations that you can't tell me, although we Members of Congress think we should know everything, how is that going and what are the changes that you feel your Department will play a role in if we continue this road of normalizing relations with Cuba?

Secretary LEW. Well, Congressman, the role that we play obviously is in the sanctions area where for most of my lifetime we have had limitations in place and they have not worked. It was an ineffective tool to change Cuba.

And the President took actions, and we took actions with our authority within the law to take steps to make it easier for there to be contact between the American people and the Cuban people, to make it easier to get information into Cuba so that they are exposed to more media and more information from the United States, and to make it easier to do certain kinds of financial transactions, both because of bank correspondent relationships and because of payment terms. We cannot eliminate all of the restrictions because we had to operate within the law, which we did.

But the purpose ultimately is to change Cuba. The purpose ultimately is for the Cuban people to see that there is a better alternative to what they have had. Since the old system did not work, we are very hopeful that the new system will be much more effective. I am not involved in the conversations that are taking place between the State Department and their counterparts in terms of the diplomatic relations, but I know those conversations have been continuing.

Mr. SERRANO. Mr. Chairman, let me just take a few seconds to just get thoughts from the Secretary. And I know that this is kind of out of left field. But one of the things that has always stuck in my mind is that for 50-odd years Cuban artists have not received royalties for the music we hear in this country, for instance. I am sure it may happen with other countries. That is not something that government is holding or would do accounting for.

Do you think that that will be on the table as part of the discussion? I mean, we are talking about a lot of money. And who would hold that money on paper? Would it be ASCAP?

Secretary LEW. I am not actually familiar with the issue of royalties for performing artists and where they reside. I am happy to look into it and get back to you.

[The information follows:]

The amendments to the regulations have not changed the situation with respect to the payment of royalties to Cuban musicians. To the extent that the sanctions impose obstacles to the payment of these royalties, OFAC has worked and is willing to continue to work with the relevant parties to consider whether the issuance of a license is necessary and appropriate.

Mr. SERRANO. I would appreciate that. I would imagine it is with ASCAP or one of these agencies. But we are talking about a lot of

money for over 50 years that not a cent has been sent because we couldn't send money over there.

Secretary LEW. Right. I am happy to look into it.

Mr. SERRANO. Thank you, sir.

Thank you.

Mr. CRENSHAW. Mr. Graves.

OPERATION CHOKE POINT

Mr. GRAVES. Thank you, Mr. Chairman.

Mr. Secretary, always good to see you and always enjoy having you before us. And it is always a spirited debate and discussion in gymnastics, in some cases. A lot of important issues we are all talking about and just wanted to, I guess, revisit one, Operation Choke Point, that I know that this committee and the Financial Services Committee in the House have been very diligent about getting to the bottom of and its effect that it has had on legally operating businesses that have been unfairly targeted and in some cases have been shut down.

Would you commit to this committee and to the House Financial Services Committee and to the full Committee on Appropriations, myself, the chairman, and ranking member, that we will get to the bottom of this and resolve this totally?

Secretary LEW. Congressman, I know that there are ongoing conversations. I understand the issues here. The objective has been to protect people from harm, not to cause problems. I am happy to follow up with you. It is not directly in my area to respond to that question, but I am happy to follow up.

[The information follows:]

The Treasury Department is not directly involved in Operation Choke Point.

Mr. GRAVES. Thank you. We would appreciate your assistance in getting to the bottom of this. And I would hope you would agree with us that really the Federal Government has no role in picking winners and losers when it comes to legally operating businesses, but we would hope that the focus would be on those who are committing crimes against innocent Americans and other financial institutions, that the focus would be there as opposed to the legally operating.

VOLCKER RULE

As well, later this year, I guess it is in July, all sizes of banks are going to be expected to be in compliance with the Volcker Rule. And in December last year the financial services industry submitted to the five regulatory agencies a proposal that was aimed at safely reducing the compliance burden for them and covered funds for legacy securitizations.

I am sure you are familiar with that proposal. And as the chairman of FSOC, can you give us a little bit of an update on that? And do you think these regulators will respond to these individuals or these organizations and this industry who submitted this proposal?

Secretary LEW. Congressman, when the Volcker Rule was designed it was designed with an understanding that institutions of

different size had different situations. So it does not apply equally to all financial institutions.

It is designed to reduce risk in the system so that financial institutions do not take on the kind of risk in their trading positions and the proprietary positions that they take that helped contribute to the financial crisis in 2008. A number of issues have come up that have been addressed subsequent to the initial rules where the regulators have taken a look at information as it has come in. I am not aware of additional action that is being taken right now, but I am happy to check on what the status is going forward.

[The information follows:]

The Volcker Rule is a key part of the Dodd-Frank Act that helps to ensure that banking organizations are focused on serving their clients rather than risky trading activities. The regulations adopted by the five rulewriting agencies to implement the Volcker Rule tailor the compliance program requirements to the size of an institution and the extent of a firm's proprietary trading and investments in private funds. The Chairperson of the FSOC had a statutory role to coordinate the regulation, and we have been closely monitoring the implementation of the Volcker Rule as it comes into effect. The agencies have taken important steps to respond to questions and comments about the rule, and the Treasury Department regularly seeks input from stakeholders about the effects of the rule. But with respect to any particular relief that may be considered, I would defer to the five agencies.

Mr. GRAVES. As chairman of FSOC, maybe you could encourage the regulators to at least respond.

Secretary LEW. Well, they have been responding on a regular basis. They do not always respond by taking the action that is requested, and those are obviously different questions.

There are a lot of financial institutions that would like the Volcker Rule to be either rolled back or withdrawn. We continue to believe that it is a provision of law and there are rules that make our financial system safer and that protect Americans from the kind of risk that we faced. I do not believe it was designed in a way that puts an undue burden on smaller institutions. When an issue that was an anomaly came up, they quickly addressed it in the early days, after the rules were made. So I know that they are listening and paying attention. But some of the things the financial institutions are asking to have taken a look at have risk attached to it that would be problematic.

So we can take a look at the specific request. But, obviously, we do not at Treasury have the authority to make any of these changes. There are five independent regulators that wrote the Volcker Rule. We helped shepherd them through the process, but they have the authority.

EFFECT OF REGULATIONS

Mr. GRAVES. Okay. Understand. And then just one more question. Again, working with the House Financial Services full committee, you were in a hearing last year. And afterwards Mr. Hensarling had written you a letter in July outlining how overwhelming evidence has shown that overregulation in the corporate bond market has had negative effects on the economy. And I believe in your testimony you downplayed it a little bit and didn't see any adverse effects.

Can you help us today to know what would you be doing as chair or have you done as chair to reexamine those cumulative effects

that many would report have occurred and maybe, since you have had a different viewpoint, have noticed something in the market?

Secretary LEW. Well, Congressman, we are constantly looking at what not just the incremental impact is, but the cumulative impact, because it is a fair question what is the cumulative impact. I think the cumulative impact has been that it is more costly for a financial institution to take more risky positions. There are more costs associated with being, in both size and activity, in riskier areas. And I think that makes the financial system safer because what it does is it internalizes a lot of the risk that had been borne essentially by the American people.

I do not believe it has an adverse effect on the economy. The economy is doing quite well right now. We would love for it to be doing even better. But I do not think there is an—there is a lot of evidence that it is because of financial reform that we are seeing the economy do well. I am not saying it is one way or the other being caused by financial reform.

I would say that having confidence in the market is something that helps the economy. To the extent that there is less uncertainty about where the rules are, that helps the economy. To the extent that the burdens cumulatively are at the level that makes institutions safer, I think that makes both the economy and the American people safer. So I do not subscribe to the theory that they have caused a lessening of economic activity.

Mr. GRAVES. I understand.

Well, thank you for your explanation. And I agree it seems the economy is doing better. I wouldn't suggest it is because of additional regulation.

Secretary LEW. No, and I was not arguing one way—

Mr. GRAVES. In spite of the additional regulation is how I might put it.

But thank you, Mr. Chairman.

Mr. CRENSHAW. Thank you.

Mrs. LOWEY.

Mrs. LOWEY. Thank you very much.

Again, we appreciate your service.

IRAN

I would like to turn to Iran for a moment because I have been very concerned by reports of various European commercial delegations traveling to Tehran in eager anticipation of sanctions relief and the prospect of doing business with Iran. And I must say, by way of background, Stuart Levey and now David Cohen have both been very professional and are doing a very thorough job.

The Administration has pledged to continue to strictly enforce existing sanctions on Iran, other than those relaxed under the interim deal. Yet I understand that Iran's oil exports are being offered from UAE trading firms acting as middlemen.

A couple of followup questions. Can you tell us the current status of overall Iranian oil exports? Are we talking to China and India, both of whom are reportedly increasing their imports from Iran this year? And if these trends continue, is the administration going to sanction those countries? Specifically, what are the exports to China, India, and Turkey? And will you make publicly available

the Department's country-by-country estimates on Iranian oil imports?

So what is happening?

Secretary LEW. So, look, let me start with the general. I think that if you look at the Joint Plan of Action agreement, it has worked extraordinarily well. It has stopped Iran from continuing to build its nuclear capacity, the first time in over a decade that anything has slowed down, much less turned back their progress. It had clearly denominated relief that was granted that was not enough to even come close to the additional burden ongoing sanctions are putting on their economy. Forty billion dollars a year of additional burden are the cost of sanctions going forward, and the Joint Plan of Action was in the single-digit billions of relief.

So I think if you look at where we are right now with Iran, Iran's economy is in still very difficult shape. It did not recover from the damage that we caused by putting tough sanctions in place and, frankly, I think the reason they are at the negotiating table is they want that relief, but they are only going to get it if it is an agreement that is a good agreement that ensures that Iran will not have nuclear weapons.

We have been vigilant in the enforcement of sanctions, both in terms of financial institutions and oil. I had conversations with many countries where we made it clear that we are going to continue to enforce sanctions as long as they are in effect, and I have had the acknowledgement of that, and countries do not want to get crosswise with us on that.

So I can get back to you on the specific details of what the flows are. There are always some periodic ups and downs in those numbers.

[The information follows:]

A comprehensive response can be provided in a classified setting.

Secretary LEW. But I think the bottom line is they got no more than the relief we agreed to, and that is not enough relief for the Iranian economy to turn around. The only way for them to get the kind of relief they really desire is if they concede on the key issues in a negotiation to make clear that they will not have nuclear weapons.

I think that we have made equally clear that if those negotiations fail we will be the first to call for additional sanctions, and then all options would remain on the table in terms of making sure that Iran does not have nuclear weapons.

So I am very proud of the work our team has done. I agree with you that the directors of OFAC, and now Adam Szubin, the acting director of TFI, under secretaries of TFI, have done an extraordinarily good job. Their teams have done an extraordinarily good job. They work very hard, and I think they deserve the support that we and you give them. But I do not think that there is a serious case that we have seen a backsliding on the commitment to maintain the sanctions regime.

There is, obviously, the negotiation going on, which if it reaches a conclusion would have to involve some modification. But we have also been clear that there are multiple sanctions regimes against Iran, because Iran has been a bad actor in multiple different areas.

The only sanctions that we have talked about relief from are the ones related to the nuclear issue, not the ones related to terrorism and other things.

SEQUESTRATION

Mrs. LOWEY. Maybe I will give you one general question. You have made clear that the President will not accept a budget that reverses our economic progress by locking in sequestration. What did you mean by this?

Secretary LEW. I think that the challenge is going to be for Congress to come back and do another version of what was done in the Murray-Ryan agreement.

Sequestration was never meant to take effect. It was designed to be something that was so odious to both sides it would make it possible to come together on the kind of balanced policies that would be a reasonable way to reduce the deficit as opposed to draconian cuts in discretionary spending. I do not think it is good for domestic priorities. I do not think it is good for our national security priorities.

I find it somewhat odd that something that was meant to be so objectionable that it would be a motivation to do something as an alternative is now seen by some as something that has to be protected. Its purpose was to be a catalyst for different action.

I think what the President is saying is Congress has to do that. Congress has to go back and work on that kind of balanced approach. It worked to provide some relief for 2014 and 2015, but it did not cover 2016. So we are now back in the world of those very, very low and we think unacceptably low levels. We would look forward to working with you and others on getting that done.

Mrs. LOWEY. Well, I am delighted to have the offer to work with you, and I hope our chairman and all the other members of this committee will do the same.

Thank you very much.

Secretary LEW. Thank you.

Mr. CRENSHAW. Thank you.

Mr. Rigell.

Mr. RIGELL. Thank you, Mr. Chairman.

And, Secretary Lew, thank you for being here. And this is really, I guess, principally one of my first hearings on this committee. It is an honor to serve on this committee.

SEQUESTRATION

I read the mission statement of the Treasury and that is certainly common ground. And let me pick up for just a moment on this, the issue of sequestration and its reversal, or at least, if not full, at least a substantive portion of it.

Just coming from my service on House Armed Services for 4 years, I have a clear understanding and our Joint Chiefs of Staff and all of our uniformed officers and, indeed, the President has said that this is going to hurt our military.

So you basically flipped it back to say it is exclusively—you may not have used that term, but it was certainly implied—that finding a way out of this is Congress' job. And I would submit that indeed we do have a lot of responsibility here, but I would say an equal

one falls to the Administration. We don't need to go back and forth and rehash how we got here exactly, but I do recall—and I believe it has not been disputed—that sequestration, at least the mechanism itself, was offered by the administration. Of course, it became law as a result of some votes here in Congress.

But I am submitting to you that the Administration itself has a responsibility to lead in this area as well. And I would like to know what, if anything, is on the table from the Administration to provide even partial lift to it.

Secretary LEW. Well, Congressman, the President's Budget provides the Administration's view as to where we would go to put together an alternate path, which would be restoring levels to pre-sequestration levels and to hit the targets for fiscal policy that we have set, which are consistent with the path.

Mr. RIGELL. Well, let's walk through that then. I think a lot of it comes down to just an assessment of risk and risk tolerance. The budget deficits that the Administration has built into its proposal to Congress are unacceptably high to me. And I would like to know what your working, your internal sense of risk is as it relates to a deficit as a percent of our gross domestic product and also our aggregate level of debt as a percent of our economy.

Secretary LEW. So, Congressman, the President's Budget presents a path of deficits coming below 3 percent of GDP and staying in a zone for the next 10 years, the immediate budget window, that hits primary balance. You still have a deficit, but the deficit is basically related to the service of old debt, not the buildup of new debt. That is generally internationally seen as something that is the goal for fiscal sustainability. In terms of—

Mr. RIGELL. Is that—and I just want to be clear—is it the 3 percent as a percent of the GDP?

Secretary LEW. Well, 3 percent primary balance, the number depends on a number of calculations. It is about 3 percent or a fraction of a point higher or lower, in that area.

Mr. RIGELL. That is widely recognized by leading economists and—

Secretary LEW. The International Monetary Fund, when it goes internationally with targets.

Now, I am not saying that the goal over time should not be in good times to have the ability to bring down the number lower than that. I presided as director of the Office of Management and Budget for 3 years in the 1990s when we had a surplus and we were paying down the debt, so I fully understand that when you have a strong economy and things are working the way they should there is an opportunity to do better than that. But in terms of fiscal sustainability, the norm of primary balance is what economists look at as being a measure of sustainability.

In terms of cumulative debt, we obviously are at a higher level than we were before we ran the very large deficits because of the spending and tax policies early in the 2000s and because of the financial crisis and what it took to get out of that. But we have slowed the growth, we have stopped the growth, and we have kept it in a range that is not as low as one would want it to be if we hadn't gone through the bad decade that we went through but is also at a sustainable level.

So I think the President's Budget, if you look at the growth in our economy, it reflects a confidence in our economy that is coming back. It reflects a sense of a sustainable economy. Very different from when we had 10 percent of GDP deficits.

Mr. RIGELL. I have got about a minute left. And I appreciate your answer, and I am kind of wrestling with some of the things that you shared. Time doesn't permit me to go back and address all of them.

BALANCED APPROACH

But for the longest time the President would say we need a balanced approach. And for a long while I was actually trying to help out with that and advocated for Republicans to move just a little bit on revenue. But so far as I can tell, in the last 4 years that I have served we have had about \$1.8 trillion in tax increases, roughly a trillion dollars in the Affordable Care Act, or as I think of it, the un-Affordable Care Act, and about another \$800 billion at the fiscal cliff.

Are you aware of any aggregate measure of any substance that meets the definition of balanced approach? That is, to me a balanced approach would mean nothing less than a one-to-one ratio of revenue to expense reductions. And I don't think we have met that standard any of the 4 years that I have been in office. Do you? Are you aware of anything? I only have a few seconds left.

Secretary LEW. Congressman, the discretionary cuts are obviously very large and they are roughly comparable to the tax increases that you have described. What is not there in a large form are the kinds of savings in mandatory programs.

Mr. RIGELL. I agree with you. We are in strong agreement there.

Secretary LEW. The President's Budget has \$400 billion of savings proposed as part of a balanced plan in mandatory programs. The challenge has been to put a balanced approach together in one package and to finish the job.

Mr. RIGELL. Secretary Lew, I thank you for your testimony. And I am going to look for some common ground here, and I mean that. And I thank the chairman, and I yield back.

Thank you.

Mr. CRENSHAW. Thank you.

Mr. Bishop.

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

Welcome, Secretary Lew.

PREPAID CARDS

Mr. Secretary, to the surprise of many in my home State of Georgia, the State is the center of gravity for the entire payments industry across the globe. In 2014, there were over \$4.4 trillion in credit card, prepaid card, and gift card transactions. Back in 2012, the Consumer Financial Protection Bureau released an advanced notice of proposed rulemaking, primarily focused on general reloadable prepaid cards, GPRs.

On November 15, 2014, CFPB released a far-reaching 870-page notice of proposed rulemaking seeking to regulate the prepaid card products. Neither the prepaid card industry, nor consumers, had

any indication or forewarning that CFPB's proposed rule would be so long and overwhelming.

The CFPB's NPR significantly expanded its rulemaking beyond GPR cards by applying new regulations to other types of prepaid cards that are currently regulated, such as student cards, government benefit cards, and payroll cards.

After the notice of the proposed rule was released, the prepaid industry and Members of Congress asked CFPB to extend the 90-day comment period for an additional 60 days. Our request was denied. In addition to the first congressional request, the Georgia congressional delegation put forth its own request, and we are still waiting for a reply.

As you may know, Federal and State governments comprise the largest groups that use prepaid products because prepaid cards are a cost-efficient payment option compared to paper checks. According to Treasury, it costs \$1.03 to issue a paper check and only 10½ cents to issue an electronic payment.

As a form of electronic payment, prepaid cards help governments at all levels disburse benefits, child support, WIC, SNAP, et cetera, in a very cost-efficient manner. Do you know or can you tell us whether CFPB conducted a cost-benefit analysis detailing the potential cost of the proposal and the cost that it would have on Federal and State governments who use prepaid cards to disburse benefits? Do you know what the cost would be to the Federal Government if we had to return to using paper checks to distribute and disburse Federal benefits?

Secretary LEW. Congressman, I do not think anyone is proposing that there be a cessation of the use of prepaid cards, and obviously, the CFBP rule is not in our direct jurisdiction. I would refer to Director Cordray and the CFPB on the details. But I know the purpose of the rule was to protect consumers and to make sure that prepaid cards, which are a growing form of a transactional tool, are managed in a way that is consistent with protecting both individuals from charges and other costs that they might not see.

I agree with you that prepaid cards are more efficient in many cases for governmental transactions and was part of turning some of our Federal benefit programs into smart cards in earlier years. So I very much understand the value of them.

Mr. BISHOP. Wouldn't the cost of compliance with an 870-page rule be significant to the parties, the States, and local governments, and any other parties that utilize the prepaid cards?

Secretary LEW. I think the CFPB has been remarkably effective in its short life designing rules that are well thought through and that are managed well in the marketplace that they are designed for. I do not think—

Mr. BISHOP. Do you know if they did a cost-benefit analysis?

Secretary LEW. I would have to defer to the CFPB on that and be happy to put the question to them.

Mr. BISHOP. The answer is, no, you don't know? You don't know?

Secretary LEW. I am not aware of what analyses they did. I do know that the purpose of the rulemaking was to protect consumers. It was not to create a bar to the use of prepaid cards on a broad basis. I would be happy to refer the question to Director Cordray.

Mr. BISHOP. I would appreciate that very much.

[The information follows:]

As a general matter, I would note that the proposed rule itself contained a cost benefit analysis of the potential impact of various provisions of the proposed rule. With respect to specifics regarding how the CFPB conducted its analysis and what are its conclusions, I would refer you to the proposed rule and the CFPB.

As for the federal government's delivery of benefits electronically through programs such as Direct Express, I am fully confident that we will be able to continue to deliver the vast majority of benefits electronically once the CFPB finalizes its rule, and that we will not have to return to a high volume of paper checks.

Mr. BISHOP. I wasn't suggesting that it was designed to be a bar to the use of prepaid cards. What I was suggesting was that the burdensome rules and rulemaking could discourage their use and could make it much more difficult. Of course, if States that have found it very efficient continue to use prepaid cards, it may increase their cost in doing it from the 10-½ cents to whatever the regulatory compliance cost would be to comply with such rules. That was my concern.

TAX PREPARER FRAUD

Georgia is number two for identity theft cases and preparer fraud. Forty-four percent of the cases in 2014 in Georgia were ID theft-related cases, and IRS has not passed any guidance regarding preparer fraud cases. Victims face financial and economic hardship as a result of the preparer absconding with refunds and leaving the taxpayer with an IRS balance due, in addition to not ever receiving the refund that the IRS rightfully owes them.

For example, there was a Georgia taxpayer in the process of purchasing a home when a preparer diverted her refund to the preparer. The taxpayer lost the home, she lost the downpayment placed on the home, and she lost her car. The taxpayer stated the preparer is getting ready to open a new tax preparation business, giving plenty of opportunities to steal refunds from additional unsuspecting victims.

As the IRS reduces tax preparation services, as your budget indicates, taxpayers are forced to seek preparation services for a fee, leaving them at risk of obtaining services from unscrupulous tax preparers. What recommendations do you have for a resolution for this problem? Is it solely an issue of increasing the budget of IRS or are there additional reforms that would be needed?

Secretary LEW. Congressman, the President's Budget requests \$101 million in investments to help combat tax-related identity theft. It would include expanding the services and assistance available to taxpayers who have been victimized by identity theft. It is a very significant problem, and I think it is one that we owe the American people to put the resources into to deal with.

We know that, in general, in the area of cyberspace, cyber crime, that there is an increasing level of activity out there. We have to keep up and find the problems as they are developing and address them because the American people deserve that. But it does require funding the activity. So I would not say it is just money. It is money that you put to the right purpose. But we have a plan which, if it is funded, we think would continue to make progress in this area.

Mr. BISHOP. Is it contained in the President's budget?

Secretary LEW. Yes, it is.

Mr. BISHOP. Thank you very much.

Secretary LEW. Thanks, Congressman.

Mr. CRENSHAW. Thank you.

Mr. Womack.

Mr. WOMACK. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for your appearance today. Interesting testimony.

When I read your bio I think there is probably not a better person out there that could sit down in the Oval Office and have a conversation, with as much know-how and experience as you have based on your time at OMB, as a chief of staff and even as the architect behind a program like AmeriCorps that I have had some experience with, to talk about, to be of counsel to the President of the United States so that when he sends a budget—and I am the new appropriator on the Budget Committee—that when he sends a budget up, that it is something that we could all kind of rally behind and try to find some common ground on and that sort of thing.

LONG-TERM BUDGET PLANNING

So here is my question for you. When you sit down in the Oval Office with the President and you talk about the next 10-year window, particularly as it concerns deficit spending and the need for us to find meaningful and sustainable reforms in our social safety net program that we all know, everybody up here knows, is driving a lot of the deficit and contributing to our national debt, what is that conversation like? What advice do you give the President?

Secretary LEW. Well, Congressman, obviously any conversations I have with the President in the Oval Office, under any of the roles that I have served in the Administration, deserve the privacy of the Oval Office.

But I think the actions that we have taken over the Administration—I was part of it at OMB and part of it when I was as chief of staff to the President—it was trying to find a balanced approach where we did all the different things that you needed to do to fix the fiscal challenges. That obviously did not work, and we ended up doing things piecemeal. So we have gotten discretionary cuts and we have gotten some of the revenue measures. We have not had the conversation where all the pieces came together and we had a comprehensive approach.

There were moments when I thought we were close to getting that kind of an agreement. I thought at the time that it would have been the right thing. As we look at the depth of the sequestration cuts, I think it is clear that discretionary spending has borne more of the burden than it should. My view is that, on the revenues, we have not completed the job and we have not really gotten where we need to go on some of the mandatory programs.

I do think that what we have seen in healthcare costs has been very meaningful in terms of the reduction in the rate of growth of healthcare spending. Whatever one's view of the Affordable Care Act—I, obviously, think it is a very important initiative—the effect in the years since the passage of the Affordable Care Act is to have the slowest rate of increased cost in health care in a very, very long

time, which has enormous impact on budgetary projections given the size of healthcare spending as a percentage of the budget.

So I think if you look at our actions, I will have to leave your imagination the conversations in the Oval Office.

Mr. WOMACK. I will take that, I guess.

Yesterday, I went to the floor on a leadership hour and we talked about budget with a couple of my colleagues. I threw up a chart on mandatory spending and the squeeze that it is putting on the discretionary piece. As an appropriator, I have had a first-row seat to that, so I see the squeeze that is happening.

And in the not-too-distant future it is obvious to me that unless we have massive tax increases we are going to have a very difficult time addressing even the basic functions of government, including turning the lights on in this Capitol.

MANDATORY SPENDING

When you look at the net interest on the debt—and I know that it is north of \$200 billion today—as you look at the 10-year window out to 2025, before my 2-year old grandson turns 12, and before my 8-year old can vote, the net interest on the debt is projected to be—in the President's budget—\$785 billion. That is a staggering number. I would argue that it is an unsustainable number and that the markets will speak very loudly long before we ever get to \$785 billion.

So how serious are you about looking at the mandatory side of spending, the two-thirds of spending that is on autopilot right now that is getting worse by the day, how serious are you about addressing that? And why do we not see a better depiction of it in the President's budget?

Secretary LEW. Congressman, first of all, obviously nominal dollars tell one story, but if you look at it in the context of the size of the economy and what the world will look like 10 years from now, we are now in a \$17 trillion GDP economy, it is projected to be \$27 trillion. So it is going to be a much larger economy. The number, while it is a large number, is not growing as a percentage of GDP anywhere near the rate that the nominal dollars are growing.

I have thought for a long time that there needs to be a bit of a space in the political debate for the conversation on finishing the fiscal job to be done as required. We have not seen that in the last few years. We have seen tremendous progress, though, on reducing the deficit. While I am not happy about the discretionary cuts and would like to see some alternative budgetary measures to replace sequestration, there is no question that bringing the deficit from 10 percent to 3 percent of GDP is an enormous, enormous accomplishment.

I couldn't be sitting here with confidence telling you that at 10 percent of GDP we were in a sustainable place. When we were looking at numbers, 9 percent, 8 percent, those were scary numbers. Three percent is more of a normal number. I mean, it is roughly primary balance given the size of our debt service.

The goal ought to be to do the things we can do now to grow our economy because a growing economy is the best way to solve the problem, and that is why we talk about things like infrastructure.

I mean, we are short selling infrastructure now, which is necessary both for short-term and long-term economic health, and at a time when I think there is a bipartisan view that we should be doing more on infrastructure.

So I think that what we can do in the next year or two should be to do the things we can do together to grow the economy. I am not sure going back to the debate of 2011, 2012 would be the way to solve that problem right now. We have done an awful lot. Right now doing the things that would grow the economy I think are what really require our immediate attention.

Mr. WOMACK. Mr. Chairman, can I ask one more quick question?

Mr. CRENSHAW. Sure.

Mr. WOMACK. I know we are into someone else's time, Chaka's time. And I don't want to wear out my welcome.

Mr. FATTAH. Go ahead.

INTEREST RATES

Mr. WOMACK. Real quickly, a word about what you see in the near future on interest rates.

Secretary LEW. Well, I never predict interest rates beyond what are the assumptions in our budget. Obviously, our budget shows a gradual return to more normal interest rates. We do not predict a time the Federal Reserve will make its decision on when it will move to change monetary policy. Then the markets will make their decision on how they react in terms of longer-term rates.

I think that in an economy that is growing, in an economy that is right now one of the healthiest in the world, it is a question of when, not if, interest rates start to go back up. The budget assumes interest rates that, if anything, are on the high end of what is likely to happen.

So I think, for budgetary purposes, we have been conservative and we have built in assumptions which, if I was giving my honest best guess, are probably a little on the high side. But I think that is the right thing to do for budgeting, because I do not think we ought to be putting in numbers that understate the cost of debt service.

Mr. WOMACK. I thank the Secretary.

And thank you for the additional time, Mr. Chairman. I yield back.

Mr. CRENSHAW. Mr. Secretary, I would suggest when you are asked what will happen to interest rates, you simply respond they will go down, they will stay level, they will go up, but not necessarily in that order.

Mr. Fattah.

Mr. FATTAH. Thank you, Mr. Chairman.

So the head of the International Monetary Fund this morning said that America has the best economy of any of the economies in the world in terms of our competitors. The Federal Reserve just a little while ago, in the Beige Book, says the economy is continuing to expand in almost every region and sector. We have had now 59 months of consecutive job growth. In the last 11 or 12 months, 200,000-plus jobs a month. So there is a lot to be thankful for in terms of the productivity of the American private sector.

There are remaining challenges. I want to just raise an issue that is not about now, it is about the future, and it is about our competition. So I kind of sense that we are competing with billion-plus-populated countries like China and India. We see the EU has organized itself in a grouping. And we are competitors and partners depending on the day of the week. But that America's position in the world is that we are the leader, but that lead is no longer absolute, it is relative, that there are people who are seeking to eat our lunch. I mean, they liked to have what we have. They would love to have the strength of the American economy. And they are doing the things they need to do, whether it is educating their populous, or so forth and so on. And their budgets are growing.

CONSUMPTION TAX

Now, I am interested, like in NASCAR, these cars pull into the pit, they've got all these different things. Our competitors have something that in their pit that we don't have. They have consumption taxes. 148 countries in the world use a consumption tax. We don't. And much of the time when this is discussed it is always about a VAT or something. I am not. I assume we might even be innovative enough to have a consumption tax that that wasn't a VAT or maybe an American form of a consumption tax.

Our economy is primarily driven by consumption, however we are seeking revenues as a government from areas that have much smaller bases. So the first law of tax concepts and policy is you want the broadest base possible so you can have the lowest rate, so you can have less people trying to evade it.

And I am wondering, given all of your experience—and I think my colleague raised this point about your bio—do you see a point in America where in order to continue to lead the world, to have the finest military, to do all the things that we want to do as a country, which some people are starting to, I think, understand we can't do on the cheap, I mean these things actually cost money, that the government may have to think anew about how we go about getting revenues?

We are chasing revenues in some very narrow alleys even though we have an economy that is based on consumption. We have our competitors using consumption taxes, and we don't use one at all. Okay? So when Japan went through their thing, they could say, look, we are going to raise our national consumption tax and we are going to move in a different direction.

So I would love to hear your thoughts on this.

Secretary LEW. So let me start just with the broad view of the world that you describe. I think that there is no question that our economy is being looked at globally as the leader of economic growth right now. There are other countries with emerging economies that are growing at a faster rate, but there are not any other mature developed economies that are doing as well as we are.

I think that, if anything, the world is overreliant on the United States right now, because if you look at the numbers, we are not big enough to pull everyone along, even if we grew another half a point or a point more. We can not make up for a shortfall in growth in Europe. We can not make up for a shortfall in growth in Asia.

So I think we have to want other countries to do well for the global economy to do well. And that is what I say when I meet with the Chinese: We want your economy to do well. We want you to play fair. We do not want you to break the rules. But we want you to do well. It is good for you when we do well. It is good for us when you do well.

I think that right now, after the financial crisis, we are at a moment in time where the world looked at the United States for a few years as being the cause of the financial problem. Now they look at the United States and they marvel at the resilience and ability of the U.S. economy to bounce back. There is something about the American spirit, the kind of indomitable American will to pick yourself up and get going again, but also the flexibility of our system. In a lot of countries people will not pick up and move down the street to take a job. In the United States, if there is a new industry that emerges, people go to take the jobs. They want the work.

I think the core of your question is a very important one. We need to have a revenue base that is sufficient to support having us be the leaders in the generations to come. That means we have to continue to have the best research and development. We need to continue to have the best educated workers. We need to continue to have the infrastructure that is needed for commerce in the future. And without an adequate revenue base, you can not support that.

We have put some ideas in our budget that our thoughts as to how to expand the tax base in a way that gets at the question of how do you go after a bigger, not a smaller base. If you take one specific idea, stepped-up basis that we put in, it is an attempt to get at taxing income that is never realized in a generation when it is earned, it goes tax free from one generation to another, because people do not need to take the gains in their lifetime.

When you and I retire—I will speak for myself—when I retire I will need to draw down my retirement savings. They will not be something that just sits there to be passed on. And I will pay taxes on them when I take down my IRAs and 401(k)s.

We thought it was entirely fair to say income should not be accumulated and never subject to the income tax. So that was an attempt to use our income tax-based system to broaden the base in a way that reflects principles of fairness, not saying we want to tax it more, but we want to tax it the way it would be taxed if you needed to use it in your lifetime.

There are always questions about shifting to a consumption-based or some different tax system. It is complicated, obviously. The challenge would be to design a system that would be progressive, and that is not straightforward in a consumption-based tax because people at lower income levels tend to consume a much higher percentage of their income than people at higher income levels.

Mr. FATAH. We don't have to joust about it today, but you could exempt certain income categories or look at other ways to get at it.

The real point is, is whether, given that we have used this income tax for over 100 years and given that in every survey the

American public is convinced that it is unfair—whether it is the revenue source that can carry this country for the next 100 years. If the only way someone can get elected President is to promise to cut taxes for everyone, at the same time that we are going to be competing with the Chinas and the Indias of the world to preserve our position in the world, these two things may not work together. At some point we may actually have to spend more money rather than have a debate about what we are cutting.

And so I am just wondering whether or not, we can use a tool that has some limits, the most important being that the American public doesn't believe it is fair.

Secretary LEW. It is definitely something that we think about and we always look at the academic work that is being done. I think to in a practical way shift from an income tax to a consumption tax is an enormously complicated undertaking. But I would be happy to follow up with you on this conversation.

Mr. FATTAH. I would love to talk to you about it. And, again, not now, but in the future. I do think that there needs to be some thinking about what directions the greatest country on Earth might go so that we could have a reliable revenue source. I think this might be worth having some discussions about.

Thank you, Mr. Chairman.

ABLE ACT

Mr. CRENSHAW. Thank you.

And let me ask you one final question. You have been very generous with your time. But I want to ask you about the way the IRS implements regulations, about two regulations. One was statutorily mandated. I mentioned in my opening statement about the ABLE Act. The States are going to administer that, but the IRS has to write some rules and it is supposed to be ready by July. And if you know a little bit about that bill, it is going to bring peace of mind to millions of Americans that are facing these challenges of disabilities. So a lot of States are already moving ahead to begin to administer this kind of program. And, just from your perspective, is that something, the July deadline that is in the statute, will that be able to be met?

Secretary LEW. Mr. Chairman, we are working very hard on that rule and are trying very hard to meet the deadline. I am hopeful we will. But I am happy to follow up with you as we get closer to June to give you an update on where we are.

Mr. CRENSHAW. I appreciate that. Because, again, this is one of those pieces of legislation that is going to help millions of Americans.

Secretary LEW. Yes.

501(C)(4)

Mr. CRENSHAW. The other thing is a regulation that I don't really care if you finish, and that has to do with the 501(c)(4)s. When it was promulgated, it had, like, 150,000 comments. It was pulled back. And as I understand it from the Commissioner, there was some concern that it would be kind of a wet blanket on the 2014 elections and it wasn't repromulgated. I guess it is being worked on again. And I think the Commissioner said that he doesn't want

it to look like it will impact even the 2016 elections. So it sounds like that is not on the front burner anymore.

Have you got a view on the timing of that? Again, I don't think that is statutory mandated. It is something that you all want to write and promulgate and have comments, but it doesn't sound like it is going to happen anytime soon.

Secretary LEW. Well, Mr. Chairman, the proposed rule that was put out was meant to start a discussion. It started quite a—

Mr. CRENSHAW. Firestorm.

Secretary LEW [continuing]. Firestorm of a discussion, and the 150,000 comments all require attention. There has been a process by which work has been ongoing to understand and think through the issues. I can not give you a schedule, but I can tell you that there is going to be a very careful process as we go forward, and we are always attentive to comments on important matters.

Mr. CRENSHAW. Great. Well, thank you very much. And thank you for your time today. You have got a big job, tough job. And if we can work together, we would like to do that.

Again, thank you for being here today.

Secretary LEW. Thank you, Mr. Chairman.

Mr. CRENSHAW. The hearing is adjourned.

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Questions for the Record Submitted by Chairman Ander Crenshaw

ABLE Act Implementation

Implementation of the Achieving a Better Life Experience (ABLE) Act is very important to me. While States are responsible for administering the program, the Department needs to issue new or update multiple regulations, forms, and instructions.

Question 1: What is the Department doing to coordinate the regulatory process to meet the June 2015 deadline?

Question 2: Have there been organizational meetings? Who is participating in these meetings?

Question 3: Can we expect to see ABLE Act regulations as part of the Department's regulatory agenda in the spring?

Answer to questions 1-3:

Treasury and the IRS are currently working on proposed guidance as required by the ABLE Act. Personnel from the IRS Office of Chief Counsel and Treasury's Office of Tax Policy have been working since early January to identify the issues to be addressed in proposed regulations and to address them in order to appropriately implement section 529A of the Internal Revenue Code.

Treasury and IRS are working toward having proposed regulations issued in June 2015.

EITC Improper Payment Rate

In 2010, the Internal Revenue Service (IRS) had a record-high amount of funding as well as a record-high Earned Income Tax Credit (EITC) improper payment rate of 26.3 percent. The IRS' funding has since dropped by 10 percent and the EITC improper payment rate dropped by 9 percent, to 24 percent.

And yet, last month, you told the House Ways and Means Committee that the EITC improper payment rate was attributable inadequate IRS funding. We are not aware of any studies that have established a causal, positive, linear relationship between IRS funding and the EITC improper payment rate.

Question 4: Has the Department conducted a statistical causality test to determine whether increases in the IRS's budget leads to decreases in the EITC improper payment rate?

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Question 5: If so, how does the Department explain a record-high EITC improper payment rate of 26.3 percent in 2010 corresponding with a record-high amount of IRS funding? Or the 9 percent decrease in the EITC improper payment rate dropped by 9 percent, to 24 percent, corresponding with a 10 percent decrease in IRS funding since 2010?

I think the improper payment rate has little to do with the size of the IRS' budget and a lot to do with the complexity of the tax law.

Answer to questions 4 and 5:

Treasury and the IRS take the Earned Income Tax Credit (EITC) improper payment rate very seriously and continue to work to make every effort, given limited resources, to reduce improper payments through enforcement, education, and outreach. Treasury recognizes the important role of the EITC in keeping families out of poverty and encouraging work. The EITC is one of the most effective Federal anti-poverty programs. It helps about half of all parents at some point, and together with the refundable Child Tax Credit, keeps about 10 million Americans out of poverty each year. At the same time, the improper payment rate is too high.

The EITC improper payment rate has not changed very much over the past decade. It is important to note that IRS projects the EITC improper payment rate for each year, based on a sample of tax returns from a few years earlier that are thoroughly checked to determine compliance levels. So the FY 2010 estimate you refer to was a projection based on estimated non-compliance for Tax Year 2006. Similarly, the FY 2013 improper payment projections were based on compliance estimates for Tax Year 2010.

Each year IRS recovers or prevents about \$2 billion in improper EITC claims. But without additional funding for enforcement and legislative changes to support ongoing IRS enforcement efforts, it is likely there will be little or no growth in enforcement revenues and little improvement in the improper payment rate.

The persistence of the improper payment rate is certainly related to the complexity of the credit. First, the circumstances faced by many families are complicated, and the EITC rules are confusing to some of them, resulting in unintentional errors. Due to budget cuts, the IRS has insufficient resources to help all the taxpayers who are trying to comply with the rules. Second, EITC eligibility depends on factors such as the residency of the taxpayer and child that IRS cannot readily observe and for which there is no reliable third-party data. IRS has limited ability to enforce rules about residency and relationship in the absence of complete and reliable third party data. For these reasons, the FY2016 budget includes a number of provisions to simplify or assist IRS, including: requiring that information returns, including the W-2, be submitted earlier.

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providing authority to set minimum levels of competency and integrity of paid return preparers, providing more flexible correctable error authority and simplifying the rules for those residing with a child they do not claim for EITC purposes. However, the IRS budget matters as well, since developing new sources of data, maintaining outreach, and implementing new enforcement measures to improve compliance require ongoing investment to implement these new tools and ensure they are used to improve program integrity.

Question 6: Do you think any of the rules on residency and qualifying children contribute to the unacceptably high improper payment rate?

Answer:

As noted above, the EITC is one of the most effective Federal anti-poverty programs. At the same time, the improper payment rate is too high, and the IRS continues to make every effort, given its limited resources, to reduce improper payments through education and enforcement.

The compliance problems that are most difficult to address are related to complicated family circumstances and to eligibility criteria related to children that IRS cannot readily observe – specifically, the residency test and the relationship tests. The rules may be confusing, which results in unintentional taxpayer errors, and hard for IRS to verify, which leads to misreporting that IRS cannot readily detect.

To that end, the FY2016 Budget includes several provisions to improve compliance: Providing more flexible correctable error authority and accelerating the filing of information returns like Form W-2 will help IRS deny more erroneous claims before refunds are paid. Providing authority to set minimum levels of competency and integrity of tax return preparers will help ensure that taxpayers receive accurate assistance in meeting their filing obligations. Providing an adequate budget will allow the IRS to better provide assistance to taxpayers and enforce the tax laws. And, simplification of the eligibility rules for workers who live with a qualifying child that they do not claim for the EITC will allow more of these workers to make compliant claims for the EITC.

Question 7: What is the Administration proposing to simplify the rules for claiming EITC?

Answer:

The Administration is proposing to simplify the rules for claiming the EITC for workers without children by allowing more workers to claim the childless EITC. Imagine a grandmother who lives with her adult daughter and her granddaughter and both adults have low-wage jobs. Right now, only one of the two adults may

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claim an EITC. This is because the adult who does not claim the EITC for workers with children is also not eligible to claim the EITC for workers without children because she lives with an EITC qualifying child. This rule is confusing to taxpayers, inequitable, and hard for IRS to enforce. It denies the EITC to low-wage workers whose work efforts should be encouraged.

The budget proposal would allow this grandmother and others like her to claim the EITC for childless workers by allowing claims to be made by adults who live with a qualifying child that they cannot claim for EITC purposes.

To be sure, other steps – such as earlier W-2 reporting and higher standards for paid preparers – also are needed to make the progress that is needed.

Treasury Priorities

National security is high priority for this Committee and the Office of Terrorism Financing and Intelligence (TFI) is the only Federal agency solely devoted to tracking and disrupting the financial means of our enemies for the purpose of ultimately defeating them. And yet, the Department proposes to cut funding for them by 3 percent and to increase funding for the IRS by 18 percent.

Question 8: As a matter of priority, is collecting taxes from hard-working Americans more important to the Department than defending Americans against terrorists, organized crime, and nuclear weapon proliferation?

I don't foresee a time when the need for TFI's unique expertise is not required to address known and yet unknown threats to our country. TFI is engaged in multiple, long-term endeavors around the globe and at home. Some threats are long-standing, such as Mexican drug cartels and North Korean and Iranian weapons proliferation, but other are relatively new, such as Russian aggression against Ukraine and the emergence of the Islamic State in Iraq and the Levant.

Question 9: Do you think the need for TFI has or will diminish? What is the Department's explanation for requesting reduced funding for TFI?

Answer to questions 8 and 9:

The IRS and TFI have distinct and unique missions that are not only important to the Department but benefit all Americans. The Internal Revenue Service (IRS) collects more than 90 percent of federal revenue and interacts with virtually every American. Resources invested in the bureau represent a smart investment for taxpayers, returning \$4 for every dollar invested. In recent years, a lack of sufficient funding for the IRS has had major implications for the American public and the tax system. Despite IRS's crucial role in our government, FY 2015 marks

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five years of Congress reducing the agency's funding, which is now \$1.2 billion lower than in FY 2010. The FY 2016 budget requests \$12.3 billion in base discretionary resources for the IRS, an increase of \$1.3 billion from the FY 2015 enacted level, to begin restoring taxpayer services and IRS operations and systems to acceptable levels. The Budget also proposes a \$667 million cap adjustment to support program integrity efforts aimed at restoring enforcement of current tax laws to acceptable levels and to help reduce the tax gap. This multi-year effort is expected to generate \$60 billion in additional revenue over the next ten years at a cost of \$19 billion, thereby reducing the deficit by \$41 billion. The targeted investments made in FY 2016 are expected to generate nearly \$2.8 billion in annual revenue once fully operationalized in FY 2018, returning nearly \$6 to the government for every dollar invested for these initiatives.

TFI remains a critical priority for Treasury and the need for TFI's programs remains high. The Budget requests \$109.6 million for TFI in FY 2016, a net reduction of \$2.891 million from the FY 2015 enacted level and \$7.6 million higher than the FY 2014 enacted level. The decrease is achieved by the non-recurrence of a one-time funding increase provided to TFI in the FY 2015 Consolidated Appropriations Act that was not requested. The proposed FY 2016 funding level is sufficient to support TFI's intelligence and enforcement functions with the twin aims of safeguarding the financial system against illicit use and combating rogue nations, terrorist facilitators, weapons of mass destruction proliferators, money launderers, drug kingpins, and other national security threats to include recent investments to the Insider Threat Program.

Hours of Tax Compliance

In 2012, the National Taxpayer Advocate estimates that Americans spend 6.1 billion hours on tax compliance.

Question 10: Of the more than 100 tax proposals in the 2016 budget request, which ones reduce the number of hours of tax compliance and by how many hours?

Question 11: If all of the Administration's tax proposals were enacted, how many additional hours of tax compliance would be required? How many forms and pages of instructions would the IRS be required to produce? How many lines of code would the IRS need to write or re-write?

Answer to questions 10 and 11:

A number of the President's FY 2016 Budget proposals would reduce taxpayer burden. Perhaps most importantly, the Administration proposes to substantially simplify education tax benefits by combining four current benefits into an expanded American Opportunity Tax Credit, make Pell grants excludable from income, and improve information provided by schools to assist taxpayers in filing

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their tax returns. Other proposals that would simplify the tax system and reduce filing burden include expanding and permanently increasing expensing for small business. In developing Budget proposals, Treasury's Office of Tax Analysis consulted with the IRS on issues of administrability and taxpayer compliance costs as needed. As in prior years, no quantification of the tax compliance costs was done for the FY2016 Budget proposals.

Indeed, under the Paperwork Reduction Act, burden on respondents is estimated after statutory or other authority is enacted and the affected agency takes action based on that authority. When the 2016 budget is enacted and the resultant tax code changes are finalized, the IRS will begin to produce burden estimates as they take action in the form of new regulations, notices, revenue procedures, and forms. Additionally, all changes in burden and proposed initiatives to reduce burden will be reported in the annual Information Collection Budget (ICB) report compiled by the Office of Information and Regulatory Affairs.

Preventing Fraud

Last week, the National Taxpayer Advocate testified that some countries and States do not pay tax refunds until a month or two after the tax filing deadline. That gives them time to authenticate and verify the information reported on the return before paying out refunds, which prevents a lot of fraud.

In this country, the IRS processes tax returns and pays out refunds two or three months before they have much information about you. To prevent a resource intensive pay-and-chase game, the Administration is asking to accelerate the day that employers submit W-2's to the IRS.

Question 12: This is a purely academic question, but wouldn't the IRS achieve the same results from processing the returns later in the year as it would from requiring W-2's to be sent earlier?

Question 13: Is this something that the Administration considered and rejected?

Answer to questions 12 and 13:

Receipt of information returns, such as Forms W-2 and 1099, earlier in the filing season will enhance the IRS's refund fraud detection efforts when the return is filed, including detection of fraud due to identity theft. In addition, receipt of information returns earlier in the filing season assists the IRS in verifying taxpayer compliance more quickly, which provides taxpayers with an opportunity to correct errors sooner and reduce the amount of penalties and interest that may be due. As you know, the statutory deadline for filing individual income tax returns is April 15, and the IRS generally must pay interest on refunds paid more than 45 days after the due date. The President's FY 2016 Budget includes a

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proposal to accelerate the due dates for information returns. Under this proposal, information returns would be due to the IRS on the same day that copies of the information returns are required to be furnished to employees, payees, or other recipients. This approach appears to be the most appropriate way to balance all policy concerns.

Inversion Transactions

On September 22, 2014, the IRS and Treasury Department issued Notice 2014-52 which describes regulations that the intended to be issued in the future with respect to inversion transactions. Despite the absence of regulations published in the *Federal Register*, the 11-page description of these yet-to-be-released regulations published in the *Internal Revenue Bulletin* took effect immediately.

Question 14: When does the IRS and Treasury Department plan to issue temporary regulations?

Question 15: When does the IRS and Treasury Department plan to issue permanent regulations, subject to the Administrative Procedures Act?

Question 16: Is there limit to the length of time that the notice can remain in the effect in the absence of either a temporary or permanent regulation?

Answer to questions 14 - 16:

The Treasury Department and the IRS are actively working on the regulations described in Notice 2014-52. The intent is to issue the regulations in temporary and proposed form within a year. Subsequently those regulations will be finalized, taking into account comments received. The expectation is that the final regulations would be issued no later than 3 years after the temporary regulations are issued, because temporary regulations have an expiration period of 3 years. The regulations are expected to be effective as of the date Notice 2014-52 was released (September 22, 2014), because Treasury believes that the transactions addressed in the notice are abusive. A notice (including Notice 2014-52) does not have an expiration date.

Incorrect 1095As

On February 24, 2015, the Treasury Department concluded that the approximately 50,000 tax filers who already filed their taxes using incorrect 1095As issued by the Federal Marketplace do not need to file amended returns and that the IRS will not pursue the collection of any additional taxes from these individuals based on updated information in the corrected forms.

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Question 17: Please provide a citation for the part of the U.S. Code that allows the IRS to “not pursue the collection of any additional taxes from these individuals based on updated information in the corrected forms”.

Question 18: Please provide a copy of the formal written notice, guidance, or instruction from the Secretary, Commissioner, or Deputy Commissioner that effectuates this decision.

Question 19: Will the IRS not act on all corrected 1095A’s this year? Or just these 50,000? How is the IRS going to treat the other 750,000 potentially incorrect 1095As sent by the Federal Marketplace?

Question 20: How is the IRS going to treat the incorrect 1095As issued by the California State run exchange? Is the IRS going to not pursue those?

Question 21: Does due process allow the IRS to ignore some corrected 1095As and not others? How does the IRS treat other corrected informational tax returns (e.g., 1099s)?

Answer to questions 17 - 21:

On March 20, 2015, the Department of the Treasury expanded the relief it announced on February 24, 2015. Under this expanded relief, individuals who were enrolled in qualifying Marketplace coverage, filed a tax return using information from a Form 1095-A, and later learned that the information on that form was incorrect do not need to file an amended return. The IRS will not pursue the collection of any additional taxes from these individuals based on updated information in the corrected form 1095-A. This relief applies to tax filers who enrolled through the Federally-facilitated Marketplace or through a State-based Marketplace.

The Secretary and the Commissioner have the authority under several sections of the Internal Revenue Code (including but not limited to sections 6404 and 7803) not to pursue the collection of unpaid taxes in certain circumstances, such as when the administration and collection costs involved would not warrant collection of the amounts due.

No formal guidance was issued in connection with the announcement of this relief. However, IRS issued Notice IR-2015-36 to provide estimated tax penalty relief to certain farmers and fishermen receiving corrected forms. In addition, on April 10, 2015, the IRS issued Notice 2015-30 to provide penalty relief for taxpayers who received a Form 1095-A, Health Insurance Marketplace Statement, that was delayed or believed to be incorrect. Both of these Notices are consistent with the relief described above.

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FSOC / SIFI Designations

Bringing stability to our financial markets and overall economy was the goal in setting up the Financial Stability Oversight Council (FSOC). However, concern has been expressed about the way the FSOC—which you chair—goes about making Systemically Important Financial Institution (SIFI) designations, particularly for non-banks. FSOC has recently announced a more transparent process going forward but I believe there is more to be done in this area.

You stated in our hearing that you believe the statute says when FSOC sees risk, then the council must designate. This seems to be a heavy handed and inflexible way to address systemic risk.

Question 22: Has FSOC considered giving entities under consideration for SIFI designation a way to remediate FSOC’s concerns before being designated? Why not allow entities to extricate themselves from any risky behavior before designation?

Making sure taxpayers on not on the hook for any future bailouts is important; however, passing costs of SIFI designations on to American families trying to save and invest for college or retirement is not fair either.

Question 23: How does FSOC take into consideration the burden on American families when designating SIFIs? Is this part of FSOC’s routine cost-benefit analysis?

Answer to questions 22 and 23:

The Council has a number of tools available to address risks to U.S. financial stability in addition to its designation authorities, including highlighting potential emerging threats in the FSOC’s annual reports to Congress; making recommendations to existing primary regulators to apply heightened standards and safeguards; and collecting and facilitating the sharing of information to assess threats to U.S. financial stability. FSOC’s approach to addressing risk is determined by the specific risks identified; there is no one-size-fits-all approach.

The FSOC’s three-stage review process to evaluate nonbank financial companies for potential designation for Federal Reserve supervision and enhanced prudential standards is data-driven and deliberate. Evaluations of designated companies have each taken more than a year, and during this time the FSOC has engaged extensively with companies under review to understand potential threats to financial stability that may result from a firm’s material financial distress or failure. As part of its engagement, the FSOC provides the company with a detailed written analysis documenting the key factors that contribute to the FSOC’s evaluation that can include hundreds of pages in company-specific

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analysis. Prior to any final designation by the FSOC, companies have the opportunity to discuss the FSOC's preliminary conclusions directly with FSOC members, and are provided the opportunity to submit additional information for the FSOC's consideration.

For each of the four designated companies, the FSOC determined that each company's material financial distress or failure could threaten the financial stability of the United States based on an analysis of the ten statutory factors set forth in the Dodd-Frank Act. This analysis includes an evaluation of the degree to which the company is already regulated. No company has been designated as a result of a single, marginal activity that could be fully and immediately mitigated through action by an existing regulator. Delaying a final designation to allow existing primary regulators to address the potential risk posed by these complex nonbank financial companies could add years to the already extensive evaluation process and subject the U.S. financial system to risk should the company experience financial distress during such time.

As a result, the FSOC has a robust process to review each designation on an annual basis and we take these reviews seriously. As part of this process, companies can meet with FSOC staff to discuss the scope and process for the review and to present information regarding any relevant changes, including a company restructuring, regulatory developments, market changes, or other factors. In addition, the FSOC will provide each designated company an opportunity for an oral hearing to contest its designation every five years. Taken together, this extensive engagement provides companies ample opportunity to understand the FSOC's basis for determinations and annual reevaluations.

With regard to your second question, the FSOC's duty under the Dodd-Frank Act is to designate a nonbank financial company whose distress or activities could pose a threat to U.S. financial stability. The regulations that designated firms will be subject to are established by the Federal Reserve Board (Federal Reserve), and I would defer to the Federal Reserve regarding any consideration of costs and benefits regarding the rules they adopt.

Financial Crimes Enforcement Network

In December, the Committee was advised by the Department that Financial Crimes Enforcement Network (FinCEN) was seeking to add new attorneys to its staff.

Question 24: What is the timeline for adding new attorneys to FinCEN Legal Office? Have detailees already been recruited? When will permanent employees be recruited? Please provide a position description.

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Question 25: Will any of FinCEN's authorities or responsibilities be transferred or delegated to Treasury's General Counsel (GC)? Does that require a statutory or regulatory change, or internal agency order? Please provide a copy.

Question 26: Even if none of FinCEN's authorities or responsibilities change, is there something that control coordination between FinCEN and Treasury GC such as a standard operating procedure or manual?

Answer to questions 24 – 26:

FinCEN continues to work through the details of the plan briefed in December and remains steadfast in making its enforcement function as efficient and effective as possible. As we work towards this goal we will continue to provide the Subcommittee with regular updates.

Question 27: How are FinCEN's enforcement priorities and the opening or closing of a case decided now? How will that change?

Question 28: What safeguards are in place now to ensure there is no political influence over enforcement priorities? How will that change or be fortified?

Question 29: Who will have the final say on the precise terms of negotiated civil settlements and agreements?

Question 30: Who is going to communicate the public, media, and Congress on enforcement matters? And provide coordination with law enforcement community and the intelligence community on enforcement matters?

Answer to questions 27 – 30:

See response to questions 24-26.

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Questions for the Record Submitted by Congressman Tom Graves

Aviation Federal Excise Tax

In March of 2012 an IRS Chief Counsel opinion concluded that aircraft owners employing aircraft management services that allow the use of the aircraft for occasional charter operations should be assessing the 7.5 percent commercial ticket tax on amounts paid for those management services. After a significant number of operators successfully appealed audit findings assessing the federal excise tax to aircraft management services, the IRS opinion was put on hold in May of 2013.

Secretary Lew, I understand that the Treasury Department and IRS are working on guidance to provide the correct application of aviation federal excise taxes (FET) as it pertains to aircraft management services. Due to confusion in this area of the law and after a significant number of aircraft management provider's successfully appealed the FET assessment by the IRS, in 2013 this matter was added to your priority guidance list. However, Treasury and IRS have yet to issue guidance clarifying this area of the tax code.

While I appreciate that the IRS has suspended the collection of these taxes, the Treasury and IRS have not committed to a timeline for resolving this matter. IRS audits are still ongoing, and small businesses are still vulnerable to potentially enormous tax assessments. These small businesses deserve clarity in this area of law.

Question 1: Will you commit to releasing guidance on this matter by the end of the second quarter of this year?

Answer:

Treasury and the IRS have been developing the legal and factual issues underlying the question of whether and, if so when, the air transportation excise tax should apply to aircraft management arrangements. Treasury and the IRS have met with industry representatives several times during the past two years to discuss both the legal framework and the industry practices in an effort to develop a fuller understanding of the issues. We recognize the need to provide guidance regarding the taxation of aircraft management fees as soon as practicable. We continue to work diligently on this issue and hope to be able to issue appropriate guidance soon.

FSOC and Legal Entity Identifiers

A core aspect of your mandate as the Chair of the Financial Stability Oversight Council's mission is to identify risks and provide comprehensive monitoring of the stability of our nation's financial system. Reliable and accurate data is essential if the FSOC is to achieve its mission.

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In this regard a system of Legal Entity Identifiers – or LEIs – is being developed globally to assist regulators in accurately aggregating data so that potential risks to the system can be identified. Indeed, the Office of Financial Research, the data and analysis arm of FSOC, proposed the development of LEIs in 2010.

I understand that Europe is mandating the use of LEIs for their financial institutions and counterparties but that there has been uneven and delayed progress in the United States adoption of the LEI.

Question 2: Can you reassure me that this is a priority for the FSOC and that you are strongly encouraging adoption of this foundational tool for identifying risk?

Answer:

Yes, the widespread adoption of LEI both domestically and globally would improve the ability of regulators to monitor emerging risks in the financial system. The OFR has led the global LEI initiative as it has progressed from conception to a full-fledged operational system in just a few years. These steps have driven LEI adoption across the globe, with more than 350,000 LEIs issued to entities in 180 countries as of May 2015. The Council supports these efforts and more broadly recommends that member agencies and the OFR continue to work together to promote high-quality data standards and fill data gaps where they exist.

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Questions for the Record Submitted by Congressman Kevin Yoder

FSOC

As you know, Congress specifically dictated what nonbank companies are eligible for consideration by the FSOC as a systemically important financial institution. This is spelled out in Section 102 of Dodd-Frank where a 85% of a company's revenues or assets must be "financial in nature" to even be considered for designation. What I see missing from FSOC's 3 stage designation process is "Stage Zero" where FSOC needs to show that you have jurisdiction – and I understand that some companies have been put into stage 2 that don't even meet the 85% threshold.

Question 1: What measures is FSOC taking to ensure that companies who are put through the Stage 1 thresholds are even eligible for designation, and what step are you taking to implement this foundational step in the designation process?

Question 2: Has the FSOC adopted all of the process improvements recommended by GAO in their 2012 report? If not, why not?

Answer to questions 1 and 2:

The Council considers the eligibility of each company for determination as part of its evaluation process. For companies that are designated, the Council includes this information as part of its bases for determination, which is available on the Council's website. A company is a nonbank financial company, and thus eligible for a determination by the Council, if it is predominantly engaged in financial activities, subject to certain exceptions. Section 102(a)(6) of the Dodd-Frank Act provides that a company is predominantly engaged in financial activities if at least 85 percent of the company's and all of its subsidiaries' annual gross revenues are derived from, or at least 85 percent of the company's and all of its subsidiaries' consolidated assets are related to, "activities that are financial in nature" as defined in section 4(k) of the Bank Holding Company Act of 1956, as amended. As part of its Stage 1 process, among other data, the OFR uses standard industry classification (SIC) codes as one source of information to provide an initial screen of potential companies for consideration. If publicly available information regarding a company indicates that the company is unlikely to meet the statutory threshold of being predominantly engaged in financial activities, FSOC staff may consider this information prior to beginning an active review of the company in Stage 2.

We appreciate GAO's recommendations and have made changes since 2012 consistent with most of their recommendations, including enhancing our website and better targeting our annual report recommendations. We have taken steps to

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implement the GAO's recommendations, although in some cases the recommendations may be inconsistent with the role or authorities of the Council. For example, we don't feel it is appropriate to establish formal coordination mechanisms for rulemakings conducted by independent member agencies of the Council.

As Chair of the FSOC and one of three members of the U.S delegation to the FSB (Fed, SEC, Treasury), can you tell us how this international body of the G-20 has only identified U.S. funds to review for potential GSIFI designation (global SIFI)? I note that the U.S. chairs this work stream at the FSB.

Question 3: How did you arrive at this decision to target only U.S. asset managers for review – did you vote in favor, did you abstain, did you object to the focus on only U.S. funds?

Answer:

The Financial Stability Board (FSB), in consultation with the International Organization of Securities Commissions (IOSCO), is still in the process of developing methodologies for identifying potentially global systemically important non-bank non-insurer financial institutions (NBNI G-SIFIs). In March, FSB-IOSCO published a second public consultative document of draft methodologies to identify NBNI G-SIFIs. The period for public comment is open through the end of May. This second draft version takes into account public responses received on the first consultative document published in January 2014 as well as feedback received from NBNIs, including asset managers, and industry groups in a series of FSB-IOSCO roundtables. FSB-IOSCO will again consider, where appropriate, the public comments received in revising the second consultative document.

The draft methodologies seek public comment on the appropriate level of focus for assessing the systemic importance of asset management entities, and the document states that "it does not propose any specific entities for designation". The FSB-IOSCO draft thresholds are merely an initial screen for filtering entities before the national authorities conduct a deep-dive analysis and assessment of potential systemicness. Exceeding the initial threshold does not indicate the entity is global systemically important. According to the draft methodologies, national authorities will identify the global systemically important entities in their jurisdictions.

It is important to note that FSOC's process for designating nonbank financial companies pursuant to the Dodd-Frank Act is distinct from the international processes of the FSB with respect to identifying global systemically important financial institutions. While the FSOC monitors international financial regulatory proposals and developments, the identification of a particular firm by the FSB

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does not create a legal obligation on the part of the FSOC or its members to designate the firm or even consider it for designation. It also does not indicate that the FSOC will arrive at the same conclusion if the FSOC chooses to consider the firm. The FSOC's evaluation of nonbank financial companies for potential designation is governed by the standards that Congress set forth in Section 113 of the Dodd-Frank Act and the process articulated in the FSOC's designations rule and interpretive guidance.

The FSOC recently adopted guidance that improves transparency and the manner in which it deals with entities it is considering for SIFI designation. While this is a step in the right direction, these reforms are only guidance and can be changed at any time. Furthermore, FSOC's actions did not address concerns about how it mitigates systemic risk. In particular, FSOC did not create a process that would reduce potential threats to the financial system by allowing a company or its primary regulator to address identified risks before designation.

Question 4: Shouldn't FSOC's primary focus be to identify and ensure systemic risks are addressed rather than simply delivering a non-bank entity to the Federal Reserve for yet undefined regulation?

Answer:

The FSOC takes seriously its responsibility to identify and address threats to financial stability. As part of this responsibility, the FSOC's annual report provides a broad perspective on potential risks and emerging threats to financial stability, along with recommendations to address such areas of concern. Examples of potential risks that the FSOC has identified include reliance on short-term wholesale funding, interest rate risk, and operational risks, such as cybersecurity vulnerabilities. Subsequent to each report, the Council monitors its prior year recommendations and provides regular updates at its meetings, including at a number of its open sessions, as appropriate. Additionally, the Council has designated eight systemically important financial market utilities for supervision, which enhances regulators ability to monitor and protect key parts of the nation's financial infrastructure.

With respect to its nonbank designations authority, the Council's duty under the Dodd-Frank Act is to require supervision by the Federal Reserve for nonbank financial companies whose distress or activities could pose a threat to U.S. financial stability. This responsibility is distinct from the Federal Reserve's responsibilities for developing the enhanced prudential standards that designated nonbank financial companies will be subject to.

Question 5: Would you support codifying the FSOC's recent guidance to improve process? Wouldn't that bring much needed clarity and certainty to FSOC's review of entities for SIFI designation?

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Answer:

The FSOC's process for reviewing nonbank financial companies for potential designation is publicly available in its final rule and interpretive guidance, published in 2012 and its supplemental procedures published in 2015. These documents, as well as a set of frequently asked questions about the process, are available on the FSOC's website at www.fsoc.gov. The FSOC has also posted on its website documents explaining its bases for the four nonbank designations it has made. Taken together, these documents provide a significant amount of information to the public describing the FSOC's process.

As a young organization, the FSOC has demonstrated its commitment to adapting its processes where improvements can be made, including through enhancements to its transparency policy, the adoption of additional governance procedures, and its supplemental guidance on nonbank financial company designations. Codifying such changes could limit the ability of the FSOC to continue to enhance its processes and limit its ability to be responsive to stakeholders, such as nonbank financial companies.

Question 6: Why should the FSOC deliver non-bank SIFIs to the Fed for "heightened prudential regulation" when this banking regulator has little to no experience with asset managers?

Question 7: Wouldn't it make more sense to empower the primary regulator to address any risks identified by the FSOC?

Answer to questions 6 and 7:

The FSOC is in the process of evaluating potential risks associated with asset management products and activities. This work is still in the risk identification phase and it is only one tool among several that the FSOC has at its disposal if it identifies any potential risks to financial stability that need to be addressed. It would be premature to conclude that the FSOC will designate any asset management firms for supervision by the Federal Reserve Board (Federal Reserve).

With regards to the four nonbank financial companies designated by the FSOC, these firms are subject to enhanced prudential standards and consolidated supervision by the Federal Reserve, as required by the Dodd-Frank Act. Financial company subsidiaries of these firms continue to be subject to supervision by any existing primary regulator.

The consequences of FSOC designating asset managers or mutual funds as SIFIs are quite costly – they include possible minimum capital standards (perhaps as high as 8%), supervision by the Fed, and additional fees to fund the OFR and the Fed. By designating a

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fund as a SIFI, these costs would be imposed directly on fund investors – many of whom are saving for their retirement or their children’s college education. A 2014 study by the American Action Forum found that designating asset managers or mutual funds as SIFIs could decrease investor returns by as much as 25%.

Question 8: As FSOC Chair, are you considering the impact on retirement and education savings if asset managers or funds are designated as SIFIs?

Answer:

The FSOC is in the process of evaluating potential risks associated with asset management products and activities. This work is still in the risk identification phase and it is only one tool among several that the FSOC has at its disposal if it identifies any potential risks to financial stability that need to be addressed. It would be premature to conclude that the FSOC will designate any asset management firms for supervision by the Federal Reserve Board (Federal Reserve).

With respect to designations, the regulations that designated firms will be subject to are established by the Federal Reserve, and I would defer to the Federal Reserve regarding any consideration of costs and benefits regarding the rules they adopt.

Earned Income Tax Credit

In December’s FY15 omnibus appropriations measure, Congress directed Treasury, through this Subcommittee’s report language, to fix this disparity in eligibility requirements with the goal of reducing fraud and errors in refundable tax credit programs. The Treasury is directed to ensure that the same eligibility questions are being asked of taxpayers regardless of their tax filing method (whether they are preparing their returns with a paid tax preparer or via do-it-yourself methods such as preparation software or online tools). I encourage the Treasury Department to not delay in implementing this common sense step.

Question 9: What is Treasury’s status in making this change?

I’d like to remind the Agency that they are required under law to reduce the EITC improper payment rate to less than 10%. The current number is approximately \$1 out of every \$4 EITC improperly paid.

Question 10: How does Treasury plan to bring this tax credit into compliance with IPERA?

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Answer to questions 9 and 10:

IRS and Treasury are working to improve compliance and minimize burden in both the self-prepared and paid-prepared channels. As part of this effort, we have solicited input from paid preparers and software providers. This input will inform any changes made to IRS forms and processes.

We take the EITC improper payment rate very seriously, and EITC compliance should be improved. The IRS makes every effort, given limited resources, to monitor EITC compliance and reduce improper payments. Each year IRS recovers or prevents about \$2 billion in improper EITC claims and protects between \$3 and \$4 billion in total revenue through EITC-related compliance activities. IRS also prevents another \$3 billion in EITC from being paid each year, through its identity-theft and fraud prevention enforcement programs. But the lack of sufficient funding for IRS will be an obstacle to improving on this record.

In conformance with Section 3 of the Improper Payments Elimination and Recovery Act, Treasury has proposed and notified Congress of several statutory changes that would improve EITC compliance. In addition to providing adequate resources to the IRS, as outlined in the FY 2016 Budget, these proposals include: Accelerating due dates for filing information returns, including Form W-2; Providing authority to set minimum levels of competency and integrity of tax return preparers; providing more flexible correctable error authority to deny certain erroneous EITC claims before refunds are paid; increasing civil and criminal penalties for tax-related identity theft; and simplifying the rules for claiming the EITC for taxpayers who reside with a child that they do not claim.

In addition, in order to fulfill specific requirements of Executive Order 13520 and the Improper Payments Elimination and Recovery Improvement Act, Treasury has developed supplemental measures to gauge the impact of EITC service and enforcement efforts. These measures include the amount of erroneous payments prevented or recovered through compliance activities, the amount of revenue protected from paid preparer treatments, and the number of preparer due diligence penalties proposed. These measures are reported in Treasury's Annual Financial Report, which may be found on the Treasury Department website¹.

Volcker Rule Regulatory Uncertainty

Question 11: Please comment on the effectiveness of the five separate entity regulatory nature of enforcing the Volcker rule.

¹ <http://www.treasury.gov/about/budget-performance/annual-performance-plan/Pages/default.aspx>

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Question 12: Does the administration have a suggestion to reduce the multipronged regulatory approach without diminishing the rule's effectiveness?

Answer to questions 11 and 12:

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act specifically charges the Fed, OCC, FDIC, SEC, and CFTC with developing and implementing the Volcker rule in a coordinated, consistent, and comparable manner. The purpose of this joint approach to implementation and enforcement is to ensure that the agencies administer the rule's provisions to firms under their respective jurisdictions in a manner that does not confer any unfair advantages or disadvantages, while also taking into consideration the different structures, activities, and interests of their constituent financial institutions affected by the rule.

Since issuing the final rule in December 2013, the regulators have acted quickly to consider and address issues raised by affected institutions. An example of this is when the agencies issued an interim final rule in January 2014 permitting banks to retain interests in TruPS CDOs under certain conditions, which was a response to concerns raised by primarily community and regional banks.

Resolving Regulatory Uncertainty

Recently CFTC Chairman Massad indicated to this committee that segregated margin should be counted in banks' calculations toward the leverage ratio. After that comment, Tom Hoenig representing FDIC, commented that he disagrees with Chairman Massad on this topic.

Question 13: As the head of the Financial Stability Oversight Committee, is it your job to resolve these regulatory differences?

Question 14: Can you tell the committee whether you plan to work on alleviating disagreements such as this?

Question 15: What is your opinion on this specific instance of disagreement?

Answer to questions 13 – 15:

Treasury fulfilled its statutory role of coordinating the rulemaking around the Volcker Rule, and we continue to support the efforts of the five rulewriting agencies as they implement the final rule.

The FSOC routinely monitors for threats to financial stability as part of its ongoing mission. To the extent that market developments or other macroeconomic factors result in a potential threat to financial stability, the

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Council would assess that threat, including as part of its annual report to Congress. While the FSOC has a potential role with regards to adjudicating certain regulatory disputes, it is important that the independent regulatory agencies have ample opportunity to resolve disputes in good faith through existing interagency dialogue.

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Questions for the Record Submitted by Congressman Mark Amodei

Global Insurance Regulation

The international “watchdog” group the International Association of Insurance Supervisors (IAIS) is expected to issue a plan this year calling for major US insurance companies including MetLife, Prudential and any designated by the Financial Stability Board as “important to worldwide financial stability” and suggest implementing a higher loss-absorption standard. Additionally, the IAIS issued a proposal for a global capital standard that would apply to all internationally active groups. Under Dodd-Frank, the Fed has capital-holdings regulatory authority over 1/3rd of insurers already. If the Treasury agrees to adopt these global standards, they will apply to over 50% of US insurers who have been successfully regulated at the state level thus far. In last year’s appropriations language, Congress made clear to the Treasury and the offices within that it does not have the authority to regulate insurers and the authority to do so lies with the states. It stated that the Treasury should not continue to advocate for a global standard which is at odds with the goals and prerogatives of the states. The Treasury has continued in its negotiations with out transparency and insurers and regulators alike are concerned about the end goals of the Department as well as what might be the result.

Question 1: Keeping in mind that so far the states have been successful in regulating insurance, do you think it is practical to separate solvency regulation in the federal and international arena from the state-based rate setting and conduct regulation?

Answer:

The United States plays a leadership role in developing international standards at the FSB and at the international standard setting bodies, including the International Association of Insurance Supervisors (IAIS). The U.S. IAIS participants are collectively engaged in developing international capital standards that will serve U.S. consumers, industry, and economy. When dealing with the IAIS standard-setting work, FIO, the Federal Reserve and state insurance regulators work together extensively and regularly coordinate. As the U.S. participants of IAIS, the leadership and staff of all three groups are in close and meaningful engagement.

The objectives of the IAIS are to promote effective and globally consistent supervision of the insurance industry in order to develop and maintain fair, safe and stable insurance markets for the benefit and protection of policyholders; and to contribute to global financial stability. International standards such as the Insurance Capital Standards (ICS) and higher loss absorbency (HLA) should be designed to achieve both of these goals: protecting policyholders and contributing to financial stability.

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Question 2: How can one set of federal and international regulators tell you how much capital to keep, with another regulator in the states telling you what you can charge?

Answer:

As has always been true in the insurance sector, international standards are not self-executing. Only U.S. state or federal authorities may impose a standard or requirement on a U.S. insurance organization. In the case of the United States, for firms that operate as part of a bank or savings and loan holding company or nonbank financial company designated by the Financial Stability Oversight Council (FSOC), the Federal Reserve has the authority to implement the standard. For firms not subject to oversight by the Federal Reserve, the state insurance regulators would have authority to implement the standard.

The ICS, BCR, and HLA are group-wide capital constructs, which include all insurance activities of the group. These standards, if adopted by the appropriate state and federal authorities, would be integrated into, rather than add to, the existing legal entity capital standards implemented by the states.

Question 3: Because two sets of regulatory bodies may cause conflicting enforcement issues, won't any global capital standard enforced by the Treasury ultimately lead to U.S. a federal insurance regulatory regime, which is contrary to the priorities of the state?

Answer:

As has always been true in the insurance sector, international standards are not self-executing. Only U.S. state or federal authorities may impose a standard or requirement on a U.S. insurance organization. In the case of the United States, for firms that operate as part of a bank or savings and loan holding company or nonbank financial company designated by the Financial Stability Oversight Council (FSOC), the Federal Reserve has the authority to implement the standard. For firms not subject to oversight by the Federal Reserve, the state insurance regulators would have authority to implement the standard.

Question 4: What kind of stakeholder input have you sought out and utilized during this process?

Answer:

FIO engagement with stakeholders is frequent and substantive. FIO regularly communicates and receives input from stakeholders during the development of the global ICS. FIO coordinates with the Federal Reserve, state insurance

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regulators and NAIC staff to schedule and conduct numerous calls and meetings with insurance sector stakeholders. In particular, the U.S. IAIS members have held several stakeholder meetings at Treasury to discuss the results of field testing and other technical issues related to the ICS, including in August 2014, October 2014, January 2015, and February 2015. The U.S. IAIS members also have involved industry stakeholders with technical expertise in regular calls on specific topics relating to important areas of the development of the ICS, including valuation, capital resources, capital requirements, and segmentation. The ICS consultation document issued by the IAIS also provided stakeholders with the opportunity to submit written comments on all aspects of the ICS proposal to the IAIS. FIO is also reviewing these comments and will be informed by the written input of U.S. stakeholders.

Clearstream and OFAC

In 1983, 241 servicemen and women died in the Iran sponsored bombing of marine barracks in Beirut while they were there on a peace keeping mission. In 2003, a federal judge ruled that the bombing was carried out by Hezbollah at the direction and financing of the Iranian government. The court ruled that the families of the slain service-members and those who were survived victims of the attack were able to sue the Iranian government. Since then, 1,350 family members and survivors have been in the process of litigating their claims. Multiple times over the course of the last decade, district and federal court judges have ruled in favor of the survivors and demanded over \$2 billion in payment from Iran to the survivors. Specifically, the survivors have been suing Clearstream, an international bank located in Luxemborg, to force Iran to meet their financial obligation to the survivors because of Clearstream's documented business with the Iran Central Bank through their American account housed at JPMorgan. The transactions were totaling in \$1.67 billion in transfer of payments between their US account to Luxemborg and ultimately to the Central Bank of Iran in the form of interest and principal bond payments. Clearstream claimed their transaction did not violate US-Iran sanctions because they called the "transfer" a "simultaneous book entry" and not an actual transfer of funds. The Court asked for OFAC's opinion on the matter. The Court's decision to retain the \$1.67 billion in favor of the Beirut marine survivors or to release it to Clearstream may rely on OFAC's answer, which, they have yet to give.

Question 5: When will OFAC be able to respond to the Court regarding possible Clearstream sanction violations?

Answer:

The Office of Foreign Assets Control (OFAC) was not ordered by the court to submit a response in this matter, and OFAC is not a party to the litigation. On December 9, 2014, the Honorable Katherine B. Forrest in *Peterson v. Islamic Republic of Iran*, 13-cv-9195 (SDNY), ordered JPMorgan Chase Bank, N.A. (JPMCB) to update the Court regarding its disclosure to OFAC regarding

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transfers of funds at issue in the above-referenced lawsuit. Specifically, the Court sought to receive information as to whether OFAC has expressed a view as to whether any transfer was a willful violation and/or that JPMCB did not have reasonable cause to know or suspect that such transfer would require a license or other authorization from OFAC. On December 12, 2014, JPMCB responded to the Court's order and notified the Court that OFAC had not expressed any views regarding the specific questions posed. The Court has not requested that OFAC respond to it directly on these questions.

Question 6: If OFAC finds Clearstream in violation of the law, what measures will OFAC take to ensure that Clearstream violations do not go unpunished?

Answer:

Due to longstanding Treasury policy, as well as to ensure compliance with the Trade Secrets Act and Privacy Act, we are unable to comment on open enforcement matters.

Question 7: Will OFAC ensure that the \$1.67 billion in bond proceeds collected by Clearstream through its New York bank account to the benefit of the Central Bank of Iran be blocked or recaptured?

Answer:

On February 20, 2015, Judge Forrest in *Peterson v. Islamic Republic of Iran*, 13-cv-9195 (SDNY), held that the funds in question are being held by Banca UBAE S.p.A. in Luxembourg and are outside of the Court's jurisdiction.

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Questions for the Record Submitted by Ranking Member José Serrano

Puerto Rico

Historically previous Presidents and Congresses have used tax policy to attract manufacturing and address the high level of poverty and unemployment in Puerto Rico. As a result, manufacturing today employs approximately 100,000 American workers in Puerto Rico and represents about 47% of Puerto Rico's GDP. However, as you know, Puerto Rico is in the midst of an economic crisis, and the loss of manufacturing would be a serious blow to its economy.

Question 1: How can we make sure that Puerto Rico maintains its manufacturing sector? If we are to ever get tax reform, how do we ensure that changes to our tax code are not harmful to Puerto Rico?

Question 2: Are you continuing to monitor Puerto Rico's financial situation? Is there anything else that the Administration can do?

Answer to questions 1 and 2:

The future success of manufacturing in Puerto Rico is closely tied to the broader economic condition of the Island. With this in mind, Treasury and the Administration want Puerto Rico to succeed in its efforts and continue to assist Puerto Rico by ensuring that the Commonwealth can access all existing and available federal resources. Targeted efforts to assist the manufacturing sector also remain a priority for the Administration; for example, the Commerce Department and SelectUSA helped attract Lufthansa Technik to build a Maintenance, Repair, and Operations facility in Puerto Rico.

In general, the Administration's business tax reform plan seeks to remove specific tax preferences and level the playing field for various businesses and entity types and industries so that underlying economic fundamentals drive business decision-making, not special tax provisions. Throughout the legislative process, the Administration will endeavor to ensure that Puerto Rico is not disadvantaged by business tax reform.

Treasury has been closely monitoring the fiscal situation in Puerto Rico for more than three years, which has included regular dialogue between officials in San Juan and Washington, DC. Treasury's team of financial experts who are monitoring fiscal developments on the Island are also sharing their expertise with the Commonwealth during these challenging times. While no extraordinary federal intervention is being considered, the Administration can and will continue to ensure that the Commonwealth can access all existing and available federal resources. In addition to the Department of

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Commerce's efforts to assist manufacturing development on the Island, the Department of Energy is partnering with PREPA, the local power authority, to develop long-term sustainable energy infrastructure, and the Department of Transportation is currently working with the local highway authority to help it access millions of federal dollars for road and other infrastructure projects.

Community Development Financial Institutions (CDFI), Bond Guarantee Program

Question 3: Treasury is proposing legislative changes to the Bond Guarantee program, such as reducing the minimum bond issue size from \$100 million to \$25 million, how will these changes enhance the program?

Answer:

The proposed legislative changes are designed to increase access to the Bond Guarantee Program for more community development financial institutions (CDFIs) that would like to participate. There are many CDFIs that do not have the capacity to lend or manage a \$100 million bond yet still have a need for long-term capital in their communities. The median asset size of all certified CDFI loan funds is \$24 million.

Reducing the minimum bond issue size to \$25 million will broaden the reach of the Bond Guarantee Program to more applicants and this in turn will increase the likelihood that bond loan proceeds will reach more low income communities and serve a wider array of business types.

DATA Act

Congress passed the Digital Accountability Transparency Act of 2014 and now the agencies have to implement it at the same time that budgets are under a lot of pressure. You're requesting \$20 M to comply.

Question 4: What will you be doing with that funding?

Answer:

Funding is requested to maintain Treasury's leadership role and statutory responsibilities for implementation of the DATA Act as well as the lead agency for publication of Federal award data via USASpending.gov. Funds will be used to:

- Provide expert advice and consulting to agencies (via Federal and contractor support) as they implement DATA Act, to include providing implementation

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tools, code, data exchange standards, taxonomies, and infrastructure that will reduce duplicate spending across agencies for similar services;

- Continue activities for a “data centric” approach to Federal spending data that enables timely access to discoverable and reusable financial data that can assist agencies in improved management of programs and decisions and provide improved access to taxpayers;
- Manage and continuously improve features on USASpending.gov (or a successor site) to publish consistent, reliable, and searchable Federal-wide spending data that responds to user input, to include further development of visualizations and display that improves user experience and transparency of Federal spending data, to include options for improving display of data for place-based inquiries. These improvements to USASpending.gov (or a successor site) include the enhancements necessary to meet the new requirements for DATA display in the DATA Act as well as provide resources for change in other legislation.

Small Business Support

In its first round of funding the State Small Business Credit Initiative allocated \$1.5 B to state programs that leverage private capital and support lending to credit worthy small business and small manufacturers that have been unable to access the credit needed to create jobs in their communities. You are proposing authorization of an additional \$1.5 B to build on the momentum from the first round.

Question 5: How this would work in conjunction with the funding you already have?

Answer:

Through SSBCI, Treasury allocated \$1.5 billion to 47 states, the District of Columbia, five territories and four municipalities (collectively, “states”) to support small business credit and capital programs. As of January 30, 2015, states have drawn 82 percent of available funding and 35 states have fully drawn their allocation. As states exhaust or are close to depleting their allocations many have expressed concerns about their ability to continue to maintain their programs without additional federal support. A new authorization of the SSBCI program will keep local economic development efforts strong and allow states to continue supporting small businesses, job creation, and leverage greater levels of private lending and investments.

The President's Budget proposes a new authorization for SSBCI of \$1.5 billion over 7 years to build on the momentum of the program's first round, strengthen the Federal government's relationships with state economic development agencies, and to provide capital to America's diverse community of

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entrepreneurs. The proposed extension will award \$1 billion to states through a competitive process designed to target local market needs, promote inclusion, attract private capital for start-ups and growing businesses, strengthen regional entrepreneurial ecosystems, and evaluate results, among other factors. An additional \$500 million will be awarded by an economic formula based on a state's job losses and pace of economic recovery. Extending SSBCI will reach more small businesses and test innovative new programs that draw on best practices from the program's first round.

Humanitarian Licenses

Question 6: What offices within Treasury participate in processing humanitarian licenses, what is the order in which they review them, and what is the average amount of time it takes each office to complete its review?

Answer:

The Office of Foreign Assets Control (OFAC) has a longstanding history of using its licensing authority to support humanitarian relief efforts. Consistent with U.S. foreign policy, OFAC issues general licenses – which are general authorizations to engage in certain activities without a specific license from OFAC – where appropriate, and OFAC prioritizes license applications, compliance questions, and other requests from non-governmental organizations and others seeking to provide humanitarian assistance. For example, Iran General License E authorizes NGOs to engage in certain humanitarian and civil society activities without the need for a specific license from OFAC. Where such transactions are not otherwise exempt or authorized pursuant to OFAC general licenses, OFAC considers the issuance of specific licenses to authorize the provision of humanitarian assistance notwithstanding economic sanctions, especially in countries subject to comprehensive economic sanctions and prioritizes requests for licenses to provide humanitarian assistance. OFAC typically consults with the Department of State for foreign policy guidance prior to the issuance of certain general and specific licenses.

Question 7: Are licensing decisions always communicated to applicants and are reasons for denial provided to applicants? Does Treasury make this decision or is it up to another agency?

Answer:

Yes, consistent with 31 CFR 501.802, OFAC will advise each applicant of the decision respecting filed applications. OFAC typically consults with the Department of State for foreign policy guidance prior to making decisions about the issuance of certain general and specific licenses.

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Question 8: In the past five years, what is the longest period of time between when a license from a non-profit humanitarian aid or development organization was submitted and when a final decision on that license was communicated to the applicant? What was Treasury's portion of that time period, what other agencies were involved, and what portion of the time did they use for their review process?

Answer:

OFAC received over 40,000 license requests in the past five years and has closed out more than 39,000 of those requests in that same time frame. Although OFAC does its best to prioritize requests related to humanitarian activities, we must also balance competing interests. In addition, policies may differ across programs, and some applications are more sensitive or complicated and therefore require more time to review, process, and resolve. On average, it takes about 120 days for applicants seeking to engage in humanitarian transactions to receive a response from OFAC, which may include internal review, legal review, and interagency review. However, when necessary and appropriate, OFAC has issued authorizations within days to respond to large-scale emergencies. We also regularly reevaluate the policies under our sanctions programs to see how we can reduce the processing times for specific licenses.

China

In recent years, we have seen China's influence in the Western Hemisphere, specifically in Latin America, grow quickly. Loans from China to various Latin American nations soared to \$22 billion in 2014, according to estimates from the China-Latin America Finance Database. For some of these nations, China acts as a lender of last resort, stepping in despite issues of outstanding debt, and inflation to boost the recipient country's struggling economy.

Question 9: What is the Treasury's perspective on China's growing influence in the Western Hemisphere? Is there more that the United States should be doing?

Answer:

The Western Hemisphere's trade links with China have deepened substantially over the past 15 years with Chinese import demand providing support to regional growth, and it is natural that other economic transactions should follow. In that context, the critical issue, more than the volume of lending, is the degree of transparency around Chinese lending and economic engagement in the Western Hemisphere, and whether or not this activity operates on a level playing field and is consistent with international best practice on issues such as social responsibility and environmental safeguards. And it is in the long-term interest of recipient

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countries, if they are to produce sustainable growth, to provide transparency and clarity regarding external financing and to support a level playing field for all creditors and investors.

These principles and practices are important and fundamental issues for a well-functioning economic system, which we have worked hard to enshrine in regional and global institutions.

We will continue to emphasize strongly the importance of transparency and maintaining a level playing field in our engagement with Chinese officials and with our neighbors in the Western Hemisphere.

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Questions for the Record Submitted by Congressman Mike Quigley

Sanctions on Russia

In light of Russia's recent incitement of violence in eastern Ukraine, Congress passed the Ukraine Freedom Support Act, which I was proud to support. The Administration was to provide a report on new sanctions 45 days after signing the bill into law on December 18th of last year. However, 76 days have passed and no such report has been issued. I'm concerned that the sanctions called upon in the law have not implemented.

Question 1: Can you please clarify the implementation status of these sanctions?

Question 2: Do you know when we can expect a report to be released?

Answer to questions 1 and 2:

We continue, in consultation with allies and partners, to respond to developments in Ukraine and to calibrate our sanctions to respond to Russian actions. The Act provides the President with another tool that can be utilized, as circumstances warrant.

The Act requires a report to Congress if the President exercises his waiver authority and does not take action under the Act. The Administration has determined that the measures already imposed by Treasury and other agencies under existing authorities, including those against Rosoboronexport and other Russian defense companies, satisfy the requirements of this statute. As a result, the President has not exercised the Act's waiver authority, and no report to Congress is currently required under the Act. We continue to assess the situation in Ukraine to determine whether additional sanctions under the Act or other legal authorities are warranted.

Secondly, in December of last year, the President issued an Executive Order regarding sanctions for the Crimean peninsula.

Question 3: Can you briefly explain how these sanctions are being implemented and how it has affected the Crimean economy?

Answer:

On December 19, 2014, President Obama issued E.O. 13685 which prohibits U.S. persons from engaging in new investment in the Crimea region of Ukraine; the importation to, or exportation from, Crimea of any goods, services, or technology; and any approval, financing, facilitation, or guarantee by a U.S. person of any such transaction by a foreign person. This E.O. also authorizes the Secretary of

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the Treasury, in consultation with the Secretary of State, to impose sanctions on any person determined to be operating in Crimea, to be a leader of an entity operating in Crimea, or to be owned or controlled by, or to provide material support to any person designated under this E.O. Under this authority, Treasury has already designated a major bank in Crimea and is investigating additional targets.

Together with similar measures adopted by the European Union, our restrictions are designed to deny President Putin the ability to economically integrate Crimea into Russia, a publicly stated goal of President Putin that requires significant investment in infrastructure, transport, and commerce. These restrictions have dissuaded many global firms from engaging on the peninsula and have encouraged others to abandon existing operations there. At the same time, Treasury has issued several general licenses to mitigate the impact of these measures on the people of Crimea and their ability to access essential goods and services, including a general license to authorize the sale of agricultural commodities, medicine, and medical supplies to the Crimea region of Ukraine.

We are maintaining vigilance and pursuing active diplomatic efforts to encourage states and companies to keep their distance from President Putin's Crimea projects.

Sanctions on Iran

The Administration has been clear that the sanctions relief being provided to Iran is limited, temporary and reversible. However, Iran's status as a state sponsor of terror is concerning as an influx of funding can very well be funneled into activities that threaten our national security and the security of our allies.

Question 4: How do you evaluate the current state of Iran's economy compared to its state prior to the sanctions relief that was afforded through the current nuclear negotiations?

Answer:

Iran's economy remains under enormous pressure even with the moderate sanctions relief that has been provided to Iran as it has taken certain steps related to its nuclear program. U.S. and international sanctions have denied Iran approximately \$160 billion in foregone oil revenues since 2012. In addition, Iran's inflation rate remains one of the highest in the world; the value of the rial has fallen by 12 percent since the JPOA started to be implemented; and Iran's economy remains some 15-20 percent smaller than it would have otherwise been absent our sanctions. As a result of the severe deceleration in Iran's GDP growth, even if Iran returns to its pre-2012 growth trajectory, it would take until 2020 for Iran's GDP to reach the level it would have been last year had it not been for our

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oil sanctions. The fundamentals of the Iranian economy will likely remain poor absent broad sanctions relief, which Iran will only receive if it takes corresponding steps to address the international community's concerns about its nuclear program.

Question 5: How are you ensuring that the current sanctions relief is not being funneled into terrorist activities throughout the region?

Answer:

We have been clear since the P5+1 talks started that engagement with Iran on the nuclear issue does not mean we will remain silent on other issues, and we haven't—we will continue to hold the Iranian government accountable for its actions. Separate from the nuclear talks, we have targeted Iran's human rights abuses, its support for terrorism, assistance to the Assad regime, and its destabilizing activities in the region using the broad array of sanctions that remain in full effect. Since the JPOA went into effect in January 2014, we have taken action against almost 100 individuals and entities linked to Iran, about half of which were not related to its nuclear program. We continue to designate individuals and entities associated with Iran's terrorist benefactors to include Lebanese Hizballah and Kata'ib Hizballah. In fact, Treasury has used its counterterrorism authorities against over 80 Lebanese Hizballah individuals and entities. Also, because Iran is in a major hole economically, US support to our regional allies will continue to be the best deterrent against Iranian aggression in the region. As we have continued to do under the JPOA, we will continue to work with our regional partners and counter the full range of threats Iran poses, including its terrorist activities.

Question 6: If it is found that Iran is using sanctions relief funds to support terrorist organizations, does the Treasury have a plan to penalize them appropriately?

Answer:

Yes. The broad array of sanctions on Iran's non-nuclear activities, including its human rights violations, support for terrorism, and destabilizing activities in its region, will remain in full effect and will be vigorously enforced. We have continued to take action against individuals and entities related to Iran's support for terrorism and human rights abuses since the JPOA took effect in January 2014, which is indicative of the seriousness of our intent to continue pressuring Iran over its illicit, non-nuclear activities.

As we all know the P5+1 negotiations have been underway for over a year. There is much speculation about the potential success of these diplomatic discussions. However, the President also made clear that if these talks do not succeed, Iran will face more sanctions and Congress could pass those sanctions in a day if needed.

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Question 7: If current talks are extended beyond March 24th, do you envision even more sanctions relief being provided to the Iranians? If so, what might that look like?

Question 8: Should these talks fail what additional sanctions could Treasury impose if needed? What economic tools do we have left in our toolbox to raise the pressure on Iran if the talks fail?

Answer to questions 7 and 8:

Under the Joint Plan of Action (JPOA), reached on November 24, 2013, between the P5+1 (China, France, Germany, Russia, the United Kingdom and the United States) and Iran, the U.S. committed to temporarily suspend certain sanctions and to also enable Iran to access certain restricted funds overseas. With the extension of the JPOA, this temporary sanctions relief was extended to July 10, 2015. During the negotiation period ending in November 2014, the parties established the end of March 2015 as the deadline to reach a political framework agreement and June 30, 2015 as the deadline for a final agreement. On April 2, 2015, the parties reached such a political framework, which sets forth the key parameters for a Joint Comprehensive Plan of Action (JCPOA). During the past few months, the P5+1 and Iran have been drafting the text and annexes of the JCPOA.

If negotiations break down and Iran resumes progress on its nuclear program, the sanctions relief provided under the JPOA will be terminated, and the suspended provisions will return to force. In addition, working together with Congress, we can move immediately to ratchet up the pressure on Iran by imposing additional sanctions measures. Over the past decade, we have developed a tremendous amount of insight into Iran's financial flows, its economy's weak points, and how it has attempted to evade sanctions. Any new measures will likely build upon the far-reaching financial and energy sector sanctions that were developed together with the Congress, and which we have vigorously enforced.

Cash Accounting

The cash method of accounting has long been recognized as a simple and appropriate manner in which to tax both individuals and the many businesses that are taxed at the individual rate. I was pleased to see that the President's budget request included a provision that expands the cash basis method of accounting to more businesses by increasing the revenue limit from \$5 million to \$25 million. I was also pleased that President's budget did not include any of the limitations on the cash method of accounting that we have seen in some prior Congressional tax reform proposals.

Question 9: Can you give us some background as to how the President arrived at this proposal?

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Answer:

The current law small business exceptions relating to accounting methods have arisen piecemeal over the years, have involved different concerns and were directed at different business activities, had different dollar threshold amounts (none of which were indexed for inflation), and had different methods of calculating the relevant threshold. The Administration has proposed long-term revenue neutral business tax reform that would, among other things, simplify the Tax Code for smaller businesses. Cash accounting would allow many taxpayers to conform more closely their tax accounting methods to their financial accounting methods. The Administration's cash accounting proposal would also simplify the current system by making the application of the thresholds uniform and by eliminating differences based on industry or activity classifications. In addition, the Administration believes that the dollar threshold amounts should be updated and that the uniform threshold amount should be indexed for inflation to continue to reflect changes in the economy. .

Question 10: Can you also expand on how the cash method of accounting is, in fact, simpler for most businesses to use?

Answer:

Cash-based accounting is more familiar and intuitive to most people. With some exceptions, it allows one to record income when a payment is received and to record an expense when a payment is made. There is no requirement to maintain accounts for receivables and payables. Under an accrual method of accounting, income and expense are generally recorded when the amounts are earned or incurred, respectively, and when the amounts are known with sufficient certainty. Tax accrual rules add additional requirements regarding expenses, requiring that an expense may be recorded only after "economic performance" has occurred.

The Administration's proposal does not require cash-basis accounting for small businesses. A qualifying small business generally would be able to choose the accounting method that best fits their individual situation. Each small business would be able to decide based on its own situation whether to prioritize greater accounting simplicity or greater accuracy in the annual measurement of taxable income.

Currency Manipulation

I strongly believe that we must take the necessary steps to address the serious threat of currency manipulation. The manipulation of exchange rates to gain an unfair competitive advantage is unacceptable, and more should be done to combat this practice to ensure that American businesses are competing on level playing field.

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Question 11: Can you please describe to us some of the steps Treasury is talking about to address currency manipulation?

Answer:

Treasury has put currency issues at the center of its international agenda. We are working to ensure that countries play fairly and are promoting a level international playing field for American workers and firms in all of our international engagements. Our objective is to move major economies toward market-determined exchange rate systems that are transparent, flexible, and reflect underlying economic fundamentals. Those efforts have yielded progress, to the benefit of American workers and firms, and we continue to press for more.

To achieve this, our strategy has been, and will continue to be, to leverage our engagement in the most important multilateral fora—the G-7, G-20, and the IMF—as well as bilaterally, and especially with China through the Strategic and Economic Dialogue (S&ED).

Through our leadership, Japan and other G-7 countries for the first time publicly affirmed that they will not target exchange rates and that their fiscal and monetary policies will remain oriented towards meeting domestic economic objectives using domestic policy instruments. Japan has not directly intervened the foreign exchange in over three years, and we continue to monitor Japan's policies and the extent to which they support growth through expanding domestic demand.

We have secured strong commitments in the G-20 to move more rapidly toward more market-determined exchange rate systems and exchange rate flexibility to reflect underlying fundamentals, to avoid persistent exchange rate misalignments, to refrain from competitive devaluation, and not to target exchange rates for competitive purposes.

We have made progress with China on exchange rates through our S&ED, as well as our multilateral engagement, and we continue to raise the issue regularly with our Chinese counterparts. On a trade-weighted basis, the RMB has seen a real effective appreciation of nearly 30 percent since China allowed its currency to resume appreciation in mid-2010. RMB appreciation has contributed to a decline in China's current account surplus from a peak of 10 percent of GDP before this Administration took office to just 2 percent of GDP last year.

Treasury has also pressed for stronger IMF surveillance of its members' exchange rate policy obligations. The IMF now publishes an External Sector Report that includes estimates of exchange rate misalignment for the major economies and has developed a Reserve Adequacy Metric to examine which countries accumulate excess reserves.

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I strongly agree with Members of Congress that unfair currency practices need to be addressed and that more can be done on currency issues. The currency objective in the 2015 Trade Promotion Authority bill significantly strengthens Treasury's hand in dealing with unfair currency practices, and I am committed to working with Congress on how best to accomplish this in the context of our trade agreements, and consistent with our overall strategy of bilateral and multilateral engagement.

As the Administration moves forward with its trade agenda, some have suggested giving Treasury and the Federal Reserve the ability to purchase foreign currencies as a way to counter foreign countries purchasing U.S. dollars.

Question 12: What do you think of that proposal?

Answer:

The Department of the Treasury and the Federal Reserve currently have the ability to intervene in foreign exchange markets. Treasury has put currency issues at the center of its international agenda. Our objective is to move major economies to market-determined exchange rate systems that are transparent, flexible, and reflect underlying economic fundamentals. To achieve this, our strategy has been, and will continue to be, to leverage our engagement in the most important multilateral fora—the G-7, G-20, and the IMF—as well as bilaterally, and especially with China through the Strategic and Economic Dialogue (S&ED). We have worked through these various channels to secure strong commitments and, importantly, concrete and continued implementation of these commitments.

Community Banks

I was proud to vote for Dodd-Frank in 2010 and I believe that it took us in a strongly positive direction. With an enhanced regulatory regime, liquidation authority, and a new agency devoted to protecting consumers from risky behavior, we're on our way to significantly lessening systemic risk. At the same time, however, we need to ensure that any new regulations on the banking industry provide opportunities for economic growth and do not stifle investment, innovation, and job creation. In particular, we have to make sure that we are not unintentionally hurting small and medium sized community banks. It's important to remember that these are not the banks that caused the financial crisis.

Question 13: One idea that's been proposed is the creation of a new position within the Treasury: an Assistant Treasury Secretary for Community Banks. This person would be responsible for collaborating with community banks on relevant policy making decisions. What are your thoughts on this?

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Answer:

The Assistant Secretary for Financial Institutions advises the Treasury Secretary on all aspects of banking policy and develops recommendations with an appreciation for how banks of all sizes would be impacted by regulatory or market developments. Separating large bank and community bank policy development at the Assistant Secretary-level may form unnecessary information silos and risks marginalizing community bank priorities and constituencies.

CDFIs & Bank Enterprise Award

The CDFI Fund is a vital program that helps provide economic development in underserved, distressed, and minority communities. I was happy to see that your request includes an increase in funding for the CDFI Fund.

However, I was disappointed to see that your request zeros out funding for CDFI's Bank Enterprise Award program, which is very important to my district and the state of Illinois. Over the last 20 years, the Bank Enterprise Award program has proven to be an effective tool to encourage investing and lending in economically distressed communities.

Question 14: The Treasury's own fact sheet on the Bank Enterprise Award says that the program "helps to build businesses, create jobs, develop affordable housing, and promote homeownership in low-income communities throughout the country." If this is the case, why propose to eliminate funding and what can be done to gain the Administration's support to restore it again?

Answer:

Treasury recognizes that the Bank Enterprise Award Program (BEA Program) provides important resources for FDIC-insured banks and thrifts to invest in underserved communities. However, FDIC-insured banks and thrifts are also served through the CDFI Program. In a difficult fiscal environment, the decision was made to preserve funding for this flagship program which supports all types of CDFIs including credit unions and community loan funds not just FDIC-insured banks and thrifts.

The CDFI Program will continue to provide financial and technical assistance to invest in and build the capacity of CDFI banks. This program empowers them to grow, achieve organizational sustainability, and contribute to the revitalization of their communities.

The CDFI Fund's Capacity Building Initiative also recently launched a "Preserving and Expanding CDFI Minority Depository Institutions (MDIs)" series to address the unique challenges facing CDFI MDIs. This program provides advanced training and technical assistance for CDFI MDIs to build their capacity

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to provide community development services to underserved communities and to ultimately be more competitive under the CDFI Program. This is another way in which the CDFI Fund is assisting insured depositories to increase their impact.

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