

**WRITTEN TESTIMONY OF
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COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
ON THE STATE OF THE IRS
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I. INTRODUCTION

Chairman Crenshaw, Ranking Member Serrano and Members of the Subcommittee, thank you for the opportunity to appear before you today to give you an overview of IRS operations.

I am honored to serve as IRS Commissioner and to have the opportunity to lead this agency and its dedicated employees, because I believe that the success of the IRS is vital for this country. The agency collects about \$2.9 trillion each year, which is more than 90 percent of the revenue collected by the federal government. The activities of the IRS touch virtually every American. This is a challenging time for the agency, as it must continue to fulfill its dual mission of tax compliance and taxpayer service while dealing with substantial budget reductions as well as the management problems that came to light last year.

I want to begin by outlining for you what I believe are the IRS' key challenges and what I will focus on going forward. First and foremost, we have recently started a new filing season, and our employees have spent the last several months in planning and preparation to ensure that it goes smoothly, not only to ensure proper revenue collection but also to ensure that taxpayers can fulfill their tax obligations as quickly and easily as possible.

It will also be critical to build upon the important work being done to improve tax compliance in a number of areas, including reducing refund fraud caused by identity theft. Enforcing the tax laws is vital to preserving our system of voluntary compliance. The vast majority of taxpayers are law abiding, and they must always feel confident that the system is fair, and that everyone is required to play by the rules. Along with enforcement, we must continue to improve taxpayer service, which is critical to ensuring that our system of voluntary compliance works properly. The IRS also must continue to fulfill our responsibilities to implement tax-related provisions of major legislation that Congress has enacted, including the Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA).

Another priority for our agency is to continue to address the issues and concerns surrounding applications for tax-exempt status. The management problems associated with the section 501(c)(4) application process have shaken public trust in the IRS. Under the leadership of former Acting Commissioner Danny Werfel, the IRS made a great deal of important progress in this area, and it is my job to complete the work that he began. Taxpayers need to be confident that the IRS will treat them fairly, no matter what their background or their affiliations. Public trust is the IRS' most important and valuable asset.

On the management side, I strongly believe that the success of the IRS depends on the experience, skills and enthusiasm of our employees, and I intend to do everything I can to make the most of this very valuable resource. Notwithstanding the issues associated with the 501(c)(4) process noted above, I have been very impressed by the experience and professionalism of the IRS employees I have met so far, both here in Washington and in the IRS offices I have visited over the last few weeks. I am also proud to lead an organization that has had a longstanding commitment to ensuring fairness in the workplace, and I believe that diversity and inclusion are equally critical to our mission, our employees and our customers. We cannot strive for anything less than a fully inclusive workplace.

The recent visits I have made to various IRS offices and the meetings I have had with employees reinforce my long-held belief that the people in an organization who know the most about what is going on are the frontline employees. I intend to listen to our employees and make sure they understand that we appreciate their dedication and look forward to benefitting from their insights and suggestions. I have told our employees that I will do everything possible to ensure that they have the leadership, systems and training to support them in their work and allow them to reach their full potential to best serve taxpayers.

In discussing the state of the IRS, no challenge facing our agency is greater than the significant reduction in funding that has occurred over the last several years. Later in this testimony I will outline the important work that our agency has done recently to reduce costs and increase efficiencies. But even with these efforts, which are ongoing, I am deeply concerned about the ability of the IRS to continue to fulfill its mission if the agency lacks adequate funding. Our current level of funding is clearly less than what the agency needs, especially to provide the level of taxpayer services the public has a right to expect. At the same time, we recognize that there has been a loss of confidence within Congress in regard to the way we manage operations. One of my responsibilities is to ensure that we are minimizing risks and quickly solving management and operational problems that may arise, so that Congress can be confident that, when we request additional funding, that money will be used wisely. Taxpayers provide the funds we receive and they deserve to be confident that we are careful stewards of those resources.

We will make every effort to provide the level of service that taxpayers need this filing season, but remain concerned that the level of service will fall short without adequate funding. It is vital that we find a solution to our budget problem, and I look forward to working with Congress to do just that. I hope that one of the legacies of my four years as IRS Commissioner will be that we put the agency's funding on a more solid and sustainable footing.

II. STATE OF IRS OPERATIONS

Filing Season

Each year the IRS works to deliver a smooth and successful filing season. The numbers showing what we undertake can be mind boggling. In Fiscal Year (FY) 2013, the IRS collected about \$2.9 trillion in revenue to fund the federal government, which represents more than 90 percent of all federal receipts. In FY 2013, the IRS processed 147.7 million individual tax returns and issued 109.6 million refunds to taxpayers totaling \$301.9 billion. In addition, IRS employees responded accurately to 95.7 percent of tax law questions and 96.0 percent of taxpayer account questions answered via phone.

The IRS' e-file program continued to grow in FY 2013, with 121.9 million individual returns, or 82.5 percent, filed electronically, an increase of 2.5 percent from the previous year.

Preparing for the 2014 filing season, which opened on January 31, was challenging as a result of the 16-day government shutdown last October – the longest shutdown the IRS has ever experienced. About 90 percent of our operations were closed during this period, with work being stopped, for example, for 3,000 to 4,000 IT staffers, many of whom would have been working to deliver the 2014 filing season.

After a careful review of all of the complex programming and system needs involved, the IRS made the decision to open the filing season on January 31, 2014, 10 days later than the date that was originally scheduled for e-filers to begin filing returns. The later date allowed the agency needed time to program and test its tax processing systems.

Through February 14, 2014, the IRS has received more than 39.2 million individual returns for this filing season and issued more than 31.3 million refunds for approximately \$100.5 billion. The average dollar refund is about \$3,200, and the IRS has directly deposited more than 27.7 million refunds to taxpayers thus far, an 11.2 percent increase over the same period last year.

Taxpayer Service

The IRS provides year-round assistance to taxpayers to help them fulfill their tax obligations. By assisting taxpayers with their questions before they file, we help prevent inadvertent noncompliance, thus reducing burdensome post-filing notices and other correspondence from the IRS.

The taxpayer assistance provided by the IRS comes in many forms, including: outreach and education programs; issuance of tax forms and publications, rulings and regulations; toll-free call centers; in-person help at Taxpayer Assistance Centers (TAC); and our website, IRS.gov.

For FY 2013, as a result of the ongoing decline in agency funding, the telephone level of service for taxpayers trying to reach the IRS' toll-free lines dropped to 60.5 percent, the lowest level since FY 2008. That means that approximately 40 percent of taxpayers who called were unable to reach an IRS employee, a level of service that we find unacceptable. We will do the best that we can during the remainder of this fiscal year, but even with the most energetic response by our employees, that number is not likely to improve by much, if at all, given the current level of funding the IRS receives.

One way to ameliorate, to some extent, the decline in service levels when taxpayers call is to make the information on our website more understandable and provide more web-based tools and services so that taxpayers can securely interact with the IRS just as they would in a live service channel. We continue our efforts to improve and expand the amount of tax information and web services available through IRS.gov. In FY 2013, taxpayers viewed IRS.gov web pages more than 450 million times. These taxpayers used IRS.gov to get forms and publications, find answers to their tax questions, and check the status of their refunds. Taxpayers used the "Where's My Refund?" electronic tracking tool 132 million times in FY 2012 and 250 million times in FY 2013. We expect that number to increase again this filing season.

The IRS also offers a Smartphone application, IRS2Go, that allows taxpayers to check the status of their refund and get tax news updates on their mobile devices. Earlier this month, we released an updated version of IRS2Go with new features for taxpayers to access the latest information to help them in preparing their tax returns. To date, there have been more than 3.5 million downloads of the application since its inception in 2011.

The IRS has also expanded the methods by which it communicates with taxpayers. Moving beyond traditional media, such as newspapers and broadcast news, the IRS continues to employ new technologies and social media, such as YouTube and Twitter, to reach more taxpayers and provide important service and compliance messages to them.

For the 2014 filing season we have several new digital applications that will further improve taxpayers' interaction with the IRS. One of these is IRS Direct Pay, which we introduced as a pilot program in November 2013. IRS Direct Pay provides taxpayers with a secure, free, quick and easy online option for making tax payments. Use of IRS Direct Pay will be more convenient for many taxpayers and should significantly reduce the number of paper checks that we have to process, which now total about 73 million per year.

Another innovation, which we launched in January, is Get Transcript. Get Transcript is a secure online system that allows taxpayers to view and print a record of their IRS account, also known as a transcript, in a matter of minutes. Prior to the introduction of this online tool, taxpayers had to wait five to seven days after placing an order to receive a paper transcript by mail.

We are also in the final stages of revamping the IRS Online Payment Agreement, which allows taxpayers to apply for an installment agreement online. We have streamlined the application process to make it quicker and easier. We expect to launch this improved product this spring.

The IRS' commitment to taxpayer service also means assisting taxpayers who are facing difficult economic times and other hardships in meeting their tax obligations.

One major example of our efforts in this regard is the Fresh Start initiative, which began in 2011. Under this initiative, the IRS has increased the flexibility of its collection program to help taxpayers who are struggling financially. For example, it is now easier for taxpayers to obtain lien withdrawals – that is, for the IRS to withdraw a tax lien notice that it has filed against a taxpayer – after paying back taxes owed. In addition, the IRS now allows liens to be withdrawn when a taxpayer signs a Direct Debit Installment Agreement (DDIA), which is an agreement to have the IRS automatically debit payments from a taxpayer's checking account for the agreed-upon installment amount. Another provision helps more small businesses get access to Installment Agreements if they sign up for a DDIA and have less than \$25,000 in unpaid taxes. The rules were also changed for Offers in Compromise (OIC) so that more taxpayers could qualify for a streamlined OIC. With streamlining, the IRS has more flexibility when analyzing a taxpayer's ability to pay, can make fewer requests for additional financial information or, if the information is needed, take it over the phone rather than requiring a submission by mail.

We also assisted taxpayers who are victims of crises such as natural disasters. In 2012 and 2013, the IRS moved quickly to provide tax and filing relief to victims of wildfires and tornadoes in Oklahoma, and storms and flooding in Alabama, Alaska, Colorado, Florida, Illinois, Indiana, Kentucky, Tennessee, and West Virginia. In addition, the IRS provided tax and filing relief to victims of Hurricane

Isaac in Mississippi and Louisiana, and to victims of Hurricane Sandy in Connecticut, Maryland, New Jersey, New York, and Rhode Island.

Along with natural disasters, last year the IRS provided tax filing and payment extensions to taxpayers in and around Suffolk County, Massachusetts -- which includes the city of Boston -- who were affected by the tragedy that occurred during the Boston Marathon on April 15, 2013.

Enforcement

Enforcement of the tax laws is a critical component of the U.S. tax system. The IRS strives to carry out a rigorous enforcement program, which includes: a balanced examination program to help ensure that taxpayers accurately report their income, deductions and credits; an effective collections program to collect assessed tax liabilities; and efforts to detect and stop non-compliance, fraudulent schemes, and tax crimes.

Taken together, the IRS' enforcement activities collected approximately \$53.3 billion in taxes and penalties in FY 2013, an increase of \$3.1 billion from FY 2012. Most of the increase came from a \$2.6 billion rise in revenue from cases under review at Appeals, which generally relate to examinations for much earlier years. Revenue from our Collection function, the levels of which also frequently rise and fall in tandem with the overall health of the economy, increased by nearly \$1 billion in FY 2013.

While we are pleased with the overall increase in receipts from enforcement in 2013 compared to the prior year, the total is still down by more than \$4.2 billion from four years ago, and we are concerned about the steady decline since the high point of \$59.2 billion in FY 2007. The reason for this decline is primarily due to a decline in revenue from audits, which dropped nearly \$400 million in FY 2013 to \$9.83 billion, the lowest level in a decade. This decline in audit revenue mirrors a decline in the number of returns audited. The IRS audited the returns of approximately 1.4 million individuals in FY 2013, down 5 percent from FY 2012 and the lowest level since FY 2008 when there were 1.39 million audits. The audit coverage rate – the number of audits divided by the number of tax returns – fell below 1 percent to 0.96 percent in FY 2013, the lowest level since FY 2006. Audits of high-income individuals – defined as those with \$1 million or more in income – fell 3.7 percent last year. The IRS examined approximately 61,000 business returns in FY 2013, down 13 percent from FY 2012.

The decline in individual and business audits coincided with a decrease in key enforcement staffing personnel in three major categories in FY 2013. There were 1,300 fewer enforcement personnel overall – including those responsible for exams, collection and investigations – than in FY 2012, a drop of 6.4 percent, and the lowest number in a decade. The decrease is even more pronounced

when compared with the numbers for FY 2010 when we had over 3,100 more enforcement personnel than we had in FY 2013 in these key categories.

The IRS has made progress in the Criminal Investigation (CI) area, where prosecutions recommended by IRS CI increased to 4,364 in FY 2013 from 3,701 the previous year. This is the highest level of prosecution recommendations in more than a decade. The conviction rate for cases tried in court reached 93.1 percent, also the highest in a decade. Other key Criminal Investigation measures, such as the number of investigations initiated, also increased in FY 2013.

The IRS has also made critical progress in improving international tax compliance. Through our strategic enforcement efforts and parallel voluntary disclosure programs, the IRS has provided opportunities for U.S. taxpayers with undisclosed offshore accounts or income to come back into the tax system. Since its establishment in 2009, the Offshore Voluntary Disclosure Program has resulted in more than 43,000 disclosures of underpaid or unpaid taxes and the collection of more than \$6 billion in back taxes, interest and penalties. In addition, our work on offshore tax evasion has recently included: the prosecution of three foreign banks for conspiracy to commit tax evasion resulting in restitution of \$807.5 million and forfeitures of \$48.3 million; indictments of almost two dozen foreign bank employees and investment advisors; and more than 100 indictments of U.S. citizens with hidden offshore accounts.

Another key enforcement challenge for the IRS is refund fraud, especially fraud caused by identity theft. The IRS has a comprehensive and aggressive identity theft strategy that focuses on preventing refund fraud, investigating these crimes, and assisting taxpayers victimized by identity thieves.

Regarding our fraud detection efforts, the IRS stopped 5 million suspicious returns in Calendar Year 2012 – up from 3 million suspicious returns stopped in CY 2011. This upward trend has continued: in CY 2013, we suspended or rejected 5.7 million suspicious returns, worth more than \$17.8 billion. Over the last two fiscal years, the IRS has made numerous improvements in catching fraud before refunds are issued. For example, we have implemented new identity theft screening filters to improve our ability to spot false returns before we process the return or issue the refund. We hope that these improvements will help us continue this upward trend in CY 2014.

The IRS' current fraud detection capability is strong, but it is limited by the technology in place, so we are investing in a significant new set of technologies. For instance, the Return Review Program (RRP) will greatly expand our current efforts by enhancing our real-time filtering and identity theft modeling capabilities. We are rolling out the first version of RRP in 2014, and it will operate alongside the legacy Electronic Fraud Detection System until 2016, when RRP will become our primary fraud detection system. Once RRP is fully implemented, we will have

more flexibility to stay ahead of identity thieves because we will be able to act more quickly to incorporate what we learn about fraud schemes into our filters.

The IRS has also been working to improve its efforts to assist victims of identity theft. Today, the IRS has 3,000 people working directly with victims on identity theft related cases – more than double the number of people working on these types of cases in 2011. In addition, since 2012 we have trained 40,000 employees who regularly work with taxpayers to help with identity theft situations when they arise. In CY 2013, the IRS worked with victims to resolve and close approximately 963,000 cases.

The IRS has reengineered its identity theft reporting and resolution processes to close cases more efficiently, accurately, and with less burden to the victim. In FY 2013, taxpayers who became identity theft victims received their refunds and had their account issues resolved in roughly 120 days, far more quickly than in previous years when cases could take over 300 days to resolve. We continue to look for ways to shorten the time to resolve identity theft cases and ease the burden that identity theft places on these victims.

The IRS created the Identity Protection Personal Identification Number (IP PIN) to help reduce identity theft and to permit victims of identity theft a safer means of filing their tax returns in subsequent years. The IP PIN is a unique identifier that authenticates a return filer as the legitimate taxpayer at the time the return is filed. As of December 31, 2013, we have issued more than 1.2 million IP PINs for the 2014 filing season. Also new this year, we are offering a limited pilot program to test the idea of issuing IP PINs to individuals who have not previously been identity theft victims, but who reside in three locations – Florida, Georgia, and Washington, D.C. – with high incidences of identity theft. Based on the results of this pilot, IRS will consider whether to expand issuing IP PINs prospectively to taxpayers in other locations.

The investigative work done by the IRS is a major component of our efforts to combat tax-related identity theft. CI investigates and detects tax and other financial fraud, including fraud related to identity theft. Investigations of tax fraud related to identity theft have increased significantly over the past three fiscal years. The number of investigations opened increased from fewer than 400 in FY 2011 to 900 in FY 2012, and increased again to nearly 1,500 in FY 2013. Indictments in identity theft-related cases totaled 1,050 in FY 2013, with 438 individuals sentenced and an average time to be served of 38 months.

Implementing Enacted Legislation

As noted, one of my priorities as Commissioner is to ensure that the IRS fulfills its responsibilities to implement tax-related provisions of enacted legislation. A large portion of our efforts in this regard continue to center on the ACA and FATCA. The resources needed for implementation activities for ACA and

FATCA, taken together, represent roughly 4 percent of the IRS' budget for FY 2014.

ACA Implementation Efforts

With regard to ACA implementation, I am pleased to be able to tell you that the systems and processes that the IRS developed to support enrollment in the new Health Insurance Marketplace were launched on schedule and are working as planned. In addition, the IRS has been working to implement the ACA's tax provisions, most of which are already in effect, such as the branded prescription drug fee, the tanning tax, and the medical device excise tax. We continue to focus on two significant provisions that go into effect in 2014: the premium assistance tax credit and the individual shared responsibility provision. These two provisions will have a profound impact on IRS forms and procedures beginning with the 2015 filing season, and will require additional taxpayer services and education activities.

Preparations are already well underway to modify forms and instructions, enhance education and outreach to taxpayers and their advisors, and update our systems and processes in time for the 2015 filing season.

The IRS is also focusing on ensuring that returns that erroneously or fraudulently claim refundable premium tax credits (or fail to reconcile advance payments of the credit) are efficiently identified and addressed, using Marketplace information available during the filing season as well as the ever-improving IRS tools used for all returns to address errors and fraud.

FATCA implementation efforts

FATCA is an important new tool in our offshore compliance efforts, as it 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. Withholding requirements under FATCA go into effect on July 1, 2014. Last week the IRS and Treasury released two important additional pieces of FATCA guidance for FFIs. The first piece of guidance responds to extensive comments, makes numerous corrective adjustments, and provides transition rules to the original regulations that were released last year. The second package of guidance includes provisions to coordinate FATCA reporting with pre-existing reporting and withholding rules that already affect international financial intermediaries and withholding agents. Both of these regulations are consistent with achieving FATCA's compliance goals, while trying to minimize burden.

It is important to note, however, that legal restrictions in some countries prevent FFIs from fulfilling the reporting, withholding and account disclosure requirements. For that reason, Treasury, with assistance from the IRS, is

advancing an intergovernmental approach to FATCA implementation that is focused on bilateral agreements that address these legal impediments, simplify practical implementation and reduce the costs to FFIs. As of Feb. 22, there were 22 signed Intergovernmental Agreements. The IRS FATCA registration website opened in August 2013 allowing financial institutions to begin to enter data. In January 2014 financial institutions were able to begin submitting their electronically signed FATCA agreements.

Exempt organizations

The IRS is continuing its efforts to implement broad managerial and operational improvements in the determination process for tax-exempt status. In this work we are focusing on applications for recognition of tax-exempt status under both sections 501(c)(3) and 501(c)(4).

Section 501(c)(4) organizations

Regarding the section 501(c)(4) application process, the IRS has made important progress in addressing the concerns raised by the Treasury Inspector General for Tax Administration (TIGTA) in a May 2013 report describing problems with the processing of these applications. In fact, I am pleased to report that the IRS completed action on all nine TIGTA recommendations contained in that report as of the end of January 2014.

The changes we have made in response to the TIGTA recommendations include:

- Establishing a new process for documenting the reasons why applications are chosen for further review;
- Developing new training and workshops on a number of critical issues, including the difference between issue advocacy and political campaign intervention, and the proper way to identify applications that require review of political campaign intervention activities;
- Establishing guidelines for IRS Exempt Organization (EO) specialists on how to process requests for tax-exempt status involving potentially significant political campaign intervention; and
- Creating a formal, documented process for EO determinations personnel to request assistance from technical experts.

We have reduced the inventory of section 501(c)(4) applications, including the group of 132 cases in the “priority backlog” – those that were pending for 120 days or more as of May 2013. As of February 7, 2014, 112 of those cases, or 85 percent, have been closed. Of the closed cases, 85 of them were approved, including 40 organizations that took advantage of a temporary self-certification procedure we offered in summer 2013. Of the remaining 27 closed cases, most were closed either because the organization withdrew the application or it failed to respond to our questions. To date, three applications have been formally denied. The 20 cases still open generally fall into one of two categories: either

the taxpayer has asked for (and received) additional time to respond to our questions, or the case is being litigated.

In addition, proposed regulations were released in November that are intended to provide clarity in determining the extent to which section 501(c)(4) organizations may engage in political activity without endangering their tax-exempt status. This initial guidance also seeks comments on other aspects of the section 501(c)(4) qualification requirements, including what proportion of an organization's activities must promote social welfare. There are a number of steps in the regulatory process that must be taken before any final guidance can be issued.

I believe it is extremely important to make this area of regulation as clear as possible, not only because it will help guide the IRS in proper enforcement, but because it will also give a better roadmap to applicants and help those that already have section 501(c)(4) status understand the applicable standards and properly administer their organizations. The proposed guidance also seeks comments regarding whether standards similar to those that have been proposed should be adopted to define the political activities that do not further the tax-exempt purposes of other tax-exempt organizations, which would promote consistent definitions across the tax-exempt sector.

The Treasury and IRS have requested public comment on the proposed regulations, and to date more than 68,000 comments have been received. The comment period closes tomorrow, and I can assure you that the Treasury and IRS will carefully consider all public feedback in working to ensure that the standards for tax exemption under section 501(c)(4) are clear and can be applied consistently.

Section 501(c)(3) organizations

Improving the section 501(c)(3) application process is a significant area of focus for our agency, and we have been working diligently to make the process less burdensome for applicants in a number of ways.

Our Exempt Organization (EO) group consistently receives more than 60,000 applications per year, including primarily applications for section 501(c)(3) status (as well as other types of tax-exempt status). The agency has experienced a substantial rise in applications since 2010. In FY 2013, for example, we received nearly 80,000 applications for recognition of exemption. The automatic revocations of tax-exempt status that occurred under the 2006 Pension Protection Act beginning in 2011, and the subsequent requests for reinstatement, have been a significant cause of this increase.

Those requests for reinstatement have added more than 50,000 cases to EO's workload since FY 2010. In fact, in 2013, more than 30 percent of the applications we received were from organizations seeking reinstatement

following automatic revocation. On January 2, 2014, the IRS issued Revenue Procedure 2014-11, which will make the reinstatement process more efficient for organizations whose status was automatically revoked and will allow a majority of revoked organizations to use a streamlined process to apply for retroactive reinstatement of their exempt status.

Looking beyond the issue of automatic revocations, the IRS has recently developed another way of making the determination process more efficient for section 501(c)(3) organizations. The Interactive Form 1023, *Application for Recognition of Exemption under Section 501(c)(3)*, which was made available online in September 2013, features pop-up information boxes that offer guidance on what information is needed. The form should result in more complete applications, thus reducing processing time by minimizing the IRS' need to request additional information to make a determination.

We are also examining the feasibility of creating a streamlined application process for certain organizations seeking tax-exempt status. I recently visited the Cincinnati IRS office and had the opportunity to meet with members of our Lean Six Sigma¹ team that is taking the lead on this effort. I'm excited about the work that these dedicated frontline employees are doing. They are developing a process that could potentially be used by small organizations that pose a low risk of noncompliance. The goal is to come up with a new procedure that is more efficient without introducing major risks into the system for approving applications.

We presently have a backlog of 60,000 section 501(c)(3) applications, many of them well over a year old. Our goal is to be able to report a significant decrease in this number by this time next year.

IRS Budget

For the IRS to keep making progress in all the areas mentioned above, it is critical for us to receive adequate resources. The agency continues to be in a very difficult budget environment, with our funding for FY 2014 now set at \$11.29 billion. Since FY 2010, IRS appropriations have been cut by approximately \$900 million. This represents a 7 percent cut in our annual budget since 2010 while the total population of individual and business filers grew by more than 4 percent over the same time period.

We recognize the need to become more efficient no matter what happens to our funding level. Labor is our largest operating expense and we have been very focused on managing personnel costs. By closely managing hiring and limiting

¹ Lean Six Sigma is a management reengineering methodology widely used in the private sector to improve business performance.

replacement behind attrition, the IRS has reduced the total number of full-time, permanent employees by about 10,000, or more than 11 percent, since 2010.

The IRS has also implemented significant reductions in its non-labor spending. Since 2010, the IRS has limited employee travel and training to mission-critical projects. By our estimates, training costs have been reduced by 83 percent and training-related travel costs have been reduced by 87 percent since 2010. We have expanded the use of alternative delivery methods for in-person meetings, training, conferences, and operational travel, but we need to restore some of these funds to ensure that IRS employees interacting with the public are properly trained and able to provide the answers and assistance expected.

Over the same period, the IRS also reduced spending on professional and technical service contracts by \$200 million. Additionally, the IRS generated \$60 million in printing and postage savings by eliminating the printing and mailing of selected tax packages and publications, and by transitioning to paperless employee pay statements.

Finally, in an effort to promote more efficient use of the Federal government's real estate assets and generate savings, in 2012, the IRS announced a sweeping office space and rent reduction initiative that over two years is projected to close 43 smaller IRS offices and consolidate space in many larger facilities. These measures will reduce rent costs by more than \$40 million and reduce total IRS office space by more than 1.3 million square feet by the end of FY 2014.

We will continue our efforts to find savings and efficiencies wherever we can. The IRS will continue to carry out its core responsibilities and work toward preserving the public's faith in the essential fairness and integrity of our tax system. But these budgetary constraints continue to pose very serious challenges to our efforts to enforce the tax laws and provide excellent customer service. Essentially, the federal government is losing billions in revenue collection to achieve budget savings of a few hundred million dollars. In general, IRS estimates that for every \$1 invested in the IRS budget, it produces \$4 in revenue – a 4-to-1 return.

With the IRS budget now in its fourth year of relative decline, significant effects on taxpayer services will become more apparent during the 2014 filing season. The IRS will have 11,000 fewer people working during the 2014 filing season than it had in 2010 while processing the largest number of tax returns in the agency's history. As a result, we expect that taxpayer service will be impacted this filing season as follows:

- The IRS will not be able to deliver timely service to taxpayers who phone us for tax assistance. We estimate that 18 million calls to our help lines, or 39 percent, will go unanswered this year, including at least 2 million calls from small businesses;

- The average wait time for taxpayers on the phone is expected to potentially rise to around 25 minutes per call, compared with 10 minutes in 2010; and
- The backlog of taxpayer correspondence is expected to increase significantly during the filing season, and we estimate that it will take more than 45 days to answer at least half of these letters. (Historically, 70 percent of taxpayer correspondence is answered within 30 days.)
- Taxpayers will bear the burden of a reduction in the IRS's budget because, as Forbes magazine recently noted, a reduction in IRS funding that erodes service levels "punishes" taxpayers.

In addition, earlier this year the IRS announced the elimination of two e-service offerings for professional tax preparers: Disclosure Authorization and Electronic Account Resolution. Although we worked to eliminate offerings with the lowest historical usage rates, this change still generated a great deal of concern among preparers who used the services. Unfortunately, given how tight our budget situation is, and will continue to be, we were not able to restore these services.

It is important to note that any marked deterioration in taxpayer service could create serious long-term risk for the U.S. tax system, which is based on voluntary compliance. The National Taxpayer Advocate has pointed out that approximately 98 percent of IRS tax collections in FY 2012 resulted from voluntary payments made by taxpayers. Because the IRS each year is responsible for collecting more than 90 percent of all federal tax receipts, even a small decline in voluntary compliance could have a noticeable impact on revenue.

The ongoing tight budget environment will also have a significant impact on enforcement activities. For example, we estimate that in FY 2014:

- Examinations conducted by the IRS will decline by an estimated 100,000 from FY 2013;
- The number of collection activities will decline by an estimated 190,000 from FY 2013; and
- IRS Appeals staff will process 8,000 fewer cases than in FY 2013, leaving taxpayers with more uncertainty and less ability to resolve issues they may have with regard to their tax liabilities.

Staffing needs will continue to be a significant concern under FY 2014 funding levels. Even though overall funding is consistent with FY 2013, IRS continues to need to reduce staffing to offset the cost of a government-wide 1 percent salary adjustment in January and eliminate the need for furlough days (three of which were taken by IRS employees in FY 2013). Under these budget constraints, we anticipate the number of full-time equivalents would decline by another 2,000 in FY 2014.

IRS Information Technology (IT) operations are another area that will see a significant impact from the continuing tight budget environment. We anticipate that funding in this area in FY 2014 will not be sufficient to address critical technology infrastructure needs such as: improvements to IRS.gov, our main portal for taxpayers to receive online assistance; new identity theft prevention tools; and upgrades to the basic computer software used by our employees that is needed to reduce system vulnerabilities.

Given our difficult budget situation, I note that questions have been raised about the agreement we recently reached with the National Treasury Employees Union (NTEU) involving FY 2013 performance awards for Bargaining Unit (BU) employees. As a result of sequester, the IRS initially made the tough decision to eliminate performance awards for FY 2013. However, because of negotiations with the NTEU that were already underway when I came on board in December, the IRS eventually agreed to make performance award payouts for FY 2013 of about 1 percent of the BU employee salary base, which is less than the 1.75 percent provided to these employees in previous years. It is important to note that these performance award payouts are awards based on the BU employee's performance and that these performance awards go to approximately two-thirds of the BU employees, based on decisions by their managers.

The agreement reached by the IRS and the NTEU is important for a number of reasons. First, it settles a national grievance and unfair labor practice charge, and provides performance awards to employees who had no pay raises for four years up until this year. In addition, as a result of this agreement, BU employees will for the first time be on the same schedule as everyone else at the IRS, so that payouts will be made early in the fiscal year for work performed the previous year.

After spending time with many employees in various IRS offices over the last several weeks, I am convinced that this money is best spent on our employees. I firmly believe that this investment in our employees will directly benefit taxpayers and the tax system.

Once again, I believe that it is vital for the IRS to receive adequate funding going forward in order for us to deliver on our dual mission of enforcing the tax laws and providing excellent taxpayer service. This view is shared by the IRS Oversight Board, the National Taxpayer Advocate, TIGTA, and the Internal Revenue Service Advisory Council.

III. CONCLUSION

Chairman Crenshaw, Ranking Member Serrano and members of the Subcommittee, thank you again for the opportunity to provide you with an overview of IRS operations. Our work in all of the areas I have discussed is

critical, and despite some recent successes, more needs to be done. Going forward, our biggest obstacle to further progress in all areas, including taxpayer service, will be our significantly reduced level of funding. As I recently told our employees, it is important for us to remember that the challenges and problems we face won't be solved overnight. But I am confident that, working together, and with the help of Congress, we can meet those challenges and ensure that our agency can continue to deliver for the American taxpayer in the years to come. This concludes my statement, and I would be happy to take your questions.