WRITTEN TESTIMONY OF
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ON IRS BUDGET AND CURRENT OPERATIONS
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INTRODUCTION

Chairman Crenshaw, Ranking Member Serrano and Members of the Subcommittee, thank you for the opportunity to discuss the IRS's budget and current operations.

Let me begin by expressing my appreciation to Congress, including the members of this Committee, for approving $290 million in additional funding for the IRS for Fiscal Year (FY) 2016, to improve service to taxpayers, strengthen cybersecurity and expand our ability to address identity theft. This brings the total IRS budget for FY 2016 to $11.2 billion. It is an important development for the IRS and for taxpayers, and is the first time in six years that the agency has received significant additional funding. It is a major step in the right direction, and I can assure the Congress that we will use these resources wisely and efficiently.

Even with this additional funding, however, the IRS is still under significant financial constraints. This is illustrated by the fact that the IRS appropriation remains $911 million below the FY 2010 enacted level and that the $290 million increase is less than half the amount that had been requested for FY 2016 in the three critical areas mentioned above. In addition, the IRS must absorb mandated cost increases and inflation during FY 2016 that are greater than the additional funding provided.

As a result, we will need to continue the exception-only hiring policy that began in FY 2011, leaving us unable to replace most employees we lose this year through attrition. In fact, we expect the IRS workforce to continue to shrink by another 2,000 to 3,000 full-time employees during FY 2016, equaling a loss of over 17,000 since FY 2010.

While this decline in our workforce has been occurring, the number of individual returns filed grew by more than 10 million (or nearly 7 percent), from 153 million in 2010 to 163 million in 2015. Further increasing our workload, the IRS during this period has had to implement a number of significant legislative mandates, nearly all of which came with no additional funding. These include: the Affordable Care Act (ACA); the Foreign Account Tax Compliance Act (FATCA); the Achieving a Better Life Experience (ABLE) Act, which includes a new certification requirement for professional employer organizations; and reauthorization of the Health Coverage Tax Credit (HCTC). In FY 2016, several additional legislative mandates were put in place that carried no implementation funding with which to execute them – for example, new passport restrictions, a private debt-collection program and a registration requirement for newly created 501(c)(4) organizations. We have had to defer hundreds of millions of dollars worth of important information technology (IT) projects and improvements since FY 2014 in order to meet our statutory requirements to implement the ACA.

Against this backdrop, a fact that often gets overlooked is that the U.S. is much more efficient in its tax collection operations than most other countries. According to statistics compiled by the Organization for Economic Cooperation and Development (OECD), the average OECD member country spends $8.87 to collect $1,000 of revenue, while the U.S. spends only $4.70. The tax administrations of Germany, France, the United Kingdom, Canada and Australia each spend twice as much as the IRS to collect a dollar of revenue. So while the IRS will continue to look for efficiencies in our operations, it is important to understand that we are one of the most efficient tax administrators in the world.

We continue to recognize the importance of spending taxpayer dollars wisely and working to strengthen our operations as we move forward. In that regard, the IRS has addressed a number of management problems that had developed in the past. Actions taken to solve these problems have in some cases been in place for several years. For example, spending on conferences has been reduced by 80 percent since 2010. In order to achieve this, since 2012, any division planning to spend more than $20,000 on a conference is required to obtain prior approval from the IRS Commissioner. Any proposed conference expense over $50,000 must also be approved by the Secretary of the Treasury or his designee. With regard to videos, any IRS division seeking to make a video must receive prior approval from an executive review board the agency created in 2013 for this purpose. As for performance awards, the IRS no longer pays such awards to IRS employees who are disciplined for serious misconduct issues or who have willfully failed to pay their taxes. In addition, processes are in place to ensure the IRS does not rehire former employees who had significant conduct or performance problems during prior employment with the agency.

In the tax-exempt area, the IRS has acted on all of the recommendations made by the Treasury Inspector General for Tax Administration (TIGTA) in his May 2013 report describing the use of improper criteria in reviewing applications for tax-exempt status under section 501(c)(4).The changes we made in response to those recommendations include: eliminating the use of inappropriate criteria; implementing improved and expanded training for employees; expediting the processing of section 501(c)(4) applications; and establishing a new process for documenting the reasons why applications are chosen for further review, with appropriate oversight of the entire process.

In addition, the Department of the Treasury and the IRS followed TIGTA's remaining recommendation and began the process of drafting guidance on how to measure social welfare and non-social welfare activities of section 501(c)(4) organizations. In light of language in the appropriations legislation for FY 2016, the IRS halted work on those proposed regulations.

Along with responding to TIGTA's May 2013 report, the IRS also has been working to address the recommendations by the Senate Finance Committee in its report issued last August. As we advised the Finance Committee in October, the IRS accepted all of the recommendations in the report that are within our control – those that did not involve tax policy matters or legislative action. They include 15 of the report's 18 bipartisan recommendations and also six of the recommendations in the separate sections prepared by the Majority and Minority. Moreover, I am pleased to report that the IRS has substantially completed action on all of these recommendations.

PLANNING FOR THE FUTURE OF THE TAXPAYER EXPERIENCE

Within our tight budget constraints, the IRS has also continued to analyze and develop plans for improving how the agency can fulfill its mission in the future, especially in delivering service to taxpayers and, along with that, maintaining a robust compliance program. Our goal is to improve and expand taxpayer services for all taxpayers, no matter what their circumstances.

In requesting adequate resources to allow the IRS to improve taxpayer service, it is important to point out that our goal is not to fund today's staff functions at historically high levels. We need to be, and are, looking forward to a new, improved way of doing business that involves a more robust online taxpayer experience. This is driven, in part, by business imperatives; when it costs between $40 and $60 to interact with a taxpayer in person, and less than $1 to interact online, we must reexamine how we provide the best possible taxpayer experience, in response to taxpayer expectations and demands.

The improvements we are planning are a natural outgrowth of modernizations made to our business systems over many years. These include the development and implementation of the Customer Account Data Engine 2 (CADE2), which allowed the IRS to migrate to daily processing and posting of individual taxpayer accounts, enabling faster refunds for more taxpayers, more timely account updates and faster issuance of taxpayer notices. Another advance put in place several years ago was Modernized e-File (MeF), which processes tax returns electronically in real time, rather than in several batches a day. MeF has reduced turnaround time, and allows acknowledgments to be sent much more quickly to those who transmitted the returns.

After years of study, and in response to taxpayer demand, the IRS has also worked to improve our website, IRS.gov, and to provide more web-based tools and services. These include the “Where’s My Refund?” electronic tracking tool, which was used nearly 235 million times in FY 2015, and the IRS2Go smartphone application. In FY 2015, there were more than 2.3 million downloads of the application.

With regard to compliance programs, an excellent example of actions the IRS has taken to improve interactions with taxpayers involves our Large Business and International (LB&I) division. LB&I recently restructured its operations to center around issues, rather than organizations, which will focus resources to better meet taxpayers’ evolving needs in a global environment.

An important change in the compliance area has been the development and phase-in of the Return Review Program (RRP), which delivers an integrated and unified system that enhances IRS capabilities to detect, resolve, and prevent criminal and civil tax non-compliance. Continued investment in the RRP will allow the IRS to retire the legacy Electronic Fraud Detection System (EFDS), and save between $10 million and $15 million a year.

Going forward, the IRS intends to further improve compliance programs through investment in an Enterprise Case Management (ECM) system, which will address the need to modernize, upgrade, and consolidate over 100 aging IRS case management systems. A unified case management environment will yield efficiencies by implementing standard case management functions, providing visibility across all types of tax transactions and improving data accessibility and usability.

Even with the improvements we have made and continue to make, we are at the point where we believe the taxpayer experience needs to be taken to a new level. Building on improvements made and new applications provided over the past 10 years, our goal is to increase the availability and quality of self-service interactions, which will give taxpayers the ability to take care of their tax obligations in a fast, secure, and convenient manner.

As I have discussed in numerous Congressional appearances and speeches, the idea is that taxpayers would have an account with the IRS where they, or their preparers, could log in securely, get all the information about their account, and interact with the IRS as needed. Most things that taxpayers need to do to fulfill their obligations could be done virtually, and there would be much less need for in-person help, either by waiting in line at an IRS assistance center or calling the IRS.

As we improve the online experience, we understand the responsibility we have to serve the needs of all taxpayers, whatever their age, income, or station in life. We recognize there will always be taxpayers who do not have access to the digital economy, or who simply prefer not to conduct their transactions with the IRS online. The IRS remains committed to providing the services these taxpayers need. For example, while the IRS will continue to offer more web-based services, taxpayers will still be able to call our toll-free help lines or obtain in-person assistance if that is their preferred method of receiving service from the IRS.

A good example of our commitment to serving all taxpayers, whether or not they participate in the digital economy, involves the return filing process. While the number of taxpayers who e-filed their income tax returns exceeded 85 percent last year and is expected to do so again this year, millions of people still choose to file paper returns. The IRS will not leave any taxpayer behind as we move into the future and will continue to offer taxpayers who prefer filing on paper the option to do so.

In moving toward the future of taxpayer service, it is also important to note that actions the IRS takes to help taxpayers increasingly will have a positive impact in the enforcement area, and will in turn help improve voluntary compliance. An excellent example of such an action is the Early Interaction Initiative we launched last December to help employers.

Under this initiative, the IRS seeks to identify employers who appear to be falling behind on their interim employment tax payments before they file their annual employment tax returns. The IRS will offer helpful information and guidance through contacts such as letters and automated phone messages. In the past, the first attempt by the IRS to contact an employer having payment difficulties often did not occur until much later in the process, after unpaid tax obligations were already beginning to mount. This initiative is designed to help employers stay in compliance and avoid needless interest and penalty charges. You could call this initiative a form of improved taxpayer service, or a more efficient enforcement activity. We believe that it is both.

This initiative illustrates why I believe it is important to view taxpayer service and enforcement as two sides of the same coin. While the IRS collects $50 billion to $60 billion a year as a result of our enforcement operations, those numbers pale in comparison to the more than $3 trillion that is collected each year as a result of taxpayers voluntarily fulfilling their tax obligations. That is why we continue to be extremely concerned about the decline in both taxpayer service and enforcement as a result of the continued cuts in IRS funding. These declines threaten to undercut the basic voluntary compliance fabric of our tax system. If you consider that a one-percent drop in the compliance rate translates into a revenue loss of approximately $30 billion a year, or $300 billion over the ten year budget window often used, then declining voluntary tax compliance results in a cut to the funds the government needs to operate.

THE ADMINISTRATION'S FY 2017 BUDGET REQUEST

In preparing the FY 2017 budget request, the IRS's senior leadership recognized the need to prioritize funding of key activities that help support enhanced digital service delivery discussed earlier in this testimony, while preserving the agency's core mission functions. As a result, the IRS established a new investment process and created six key strategic themes that outline how the agency will execute tax administration to meet the needs of taxpayers in the future. IRS leadership set priorities for new investments based on how those investments align with these themes:

- Facilitating voluntary compliance by empowering taxpayers with secure innovative tools and support;
- Understanding non-compliant taxpayer behavior and developing approaches to deter and change it;
- Leveraging and collaborating with external stakeholders;
- Cultivating a well-equipped, diverse skilled workforce;
- Selecting highest-value work using data analytics and a robust feedback loop; and
- Driving more agility, efficiency and effectiveness in IRS operations.

Following from these themes, the Administration's FY 2017 budget request includes a number of initiatives that provide the building blocks to move the IRS into the future. These initiatives represent a large portion of the increased funding requested in the IRS budget for FY 2017. They are as follows:

Additional funding to improve taxpayer service: $48 million. Under this initiative, the IRS will work both to improve taxpayer service delivered through traditional channels and continue modernizing the services we offer in order to help transform the taxpayer experience.

The additional staffing funded by these resources by itself will deliver phone level of service (LOS) for the full year on our toll-free helplines at 53 percent; if the President's Budget is enacted in full, the IRS will be able to combine this funding with additional resources through user fees to achieve a 70 percent LOS throughout the year. It is worth noting, however, that we expect to have the lowest user fee balance available for carryover into FY 2017 since FY 2008, meaning that we will not have that contingency available to boost service if other needs are not sufficiently funded.

In terms of modernizing the taxpayer experience, the additional funding will allow the IRS to continue moving toward the development of: secure online taxpayer accounts; secure online digital communications between the taxpayer and the IRS; and new web-based self-service products and more interactive capabilities to existing products, so that taxpayers would potentially be able to, for example, securely authenticate their identity, view and print tax records online, pay outstanding debts, enter into installment agreements, establish powers of attorney, and get tax law information.

Taken together, these improvements will ultimately allow taxpayers to resolve more issues online, leaving our employees more time to support the transactions that are best completed by phone or in person.

Additional funding to continue implementing the Affordable Care Act: $153 million. The additional funding provided by this initiative, above current resources, will allow the IRS to develop advanced technology infrastructure and applications support and to modify existing IRS tax administration systems, so the agency can continue implementing the tax-related provisions of the ACA.

For example, the funds will improve the IRS's ability to: validate taxpayer claims for the premium tax credit; collect penalties, taxes and fees related to the ACA provisions that the IRS administers; and administer the individual shared responsibility provision. The additional funding also supports administration of the new reporting requirement for health coverage providers, as well as the employer shared responsibility provision, both of which took effect in 2015.

To further illustrate the importance of funding this initiative, I would note that over the last several years the IRS has had to divert resources from other critical functions, including taxpayer services and IT, and expend user fees to fund ACA implementation. In particular, these diversions have depleted user fees and made it difficult to use those fees to help fund core mission activities and other unfunded legislative mandates.

Additional funding to leverage new technologies to advance the IRS mission: $53 million. Under this initiative, the IRS will continue using new technologies to develop critical IT systems needed to support the IRS's taxpayer service and enforcement programs. This includes making improvements to such systems as CADE2 and MeF. The IRS will also be able to provide the necessary IT infrastructure to support efforts to improve the online taxpayer experience, including the infrastructure portions of secure digital communications and more interactive capabilities to existing web-based self-service products.

Another major component of this initiative is the implementation of the Event Driven Architecture (EDA) framework, which is designed to improve return processing by allowing the IRS to process and share data internally from returns more easily. Through the use of EDA, for example, returns with minor errors can be addressed at the time of filing. Implementation of EDA is a prerequisite for a number of planned improvements to the online taxpayer experience, including immediately notifying taxpayers of errors on a return as soon as it is filed, and allowing taxpayers to self-correct return errors through an online tool.

Additional funding to help prevent stolen identity refund fraud and reduce improper payments: $90 million. The IRS has made significant progress in combatting stolen identity refund fraud over the last several years, though it has been a challenge to find the resources for investments in this area because of the ongoing cuts to our budget. We therefore appreciate the additional funding Congress approved for FY 2016 for cybersecurity and identity theft.

Nonetheless, the IRS needs to continue investing in resources and tools to stay ahead of criminals. The additional funding requested under this initiative will allow the IRS to invest in the additional staffing and technology to continue improving our efforts to: detect and prevent refund fraud related to identity theft; assist identity theft victims; and apprehend the criminals who perpetrate these crimes.

With this additional staffing, the IRS will be able to, for example: resolve taxpayer cases of tax-related identity theft more quickly, and expand the capacity of the IRS's Identity Protection Specialized Unit (IPSU) to handle additional cases; expand the IRS External Leads program, through which the IRS works in cooperation with financial institutions, state agencies and other external sources to recover fraudulent refunds; and do a better job of detecting prisoner refund fraud through the use of Prisoner Update Processing System (PUPS) data.

Technology investments under this initiative will allow the IRS to make a number of other improvements, including: reducing the use of Social Security Numbers (SSN) on IRS mailings to taxpayers; establishing a centralized fraud repository within the IRS to expand the agency's ability to identify significant tax cases and streamline and standardize the fraud referral process; and accelerating IRS access to employment tax data from the Social Security Administration (SSA).

Additional funding to improve electronic enterprise records management: $19 million. The additional funding provided under this initiative will allow the IRS to continue its efforts to manage official records more effectively through the implementation of new systems to maintain unified records of IRS policy, program and project development, and to create a unified searchable archive of IRS e-mails to avoid redundant archiving. By making these improvements, the IRS will be able to respond in a timelier manner to legal and Congressional inquiries and requests under the Freedom of Information Act (FOIA). These improvements, which will be phased in over several years, will allow the IRS to more easily comply with various recordkeeping requirements under the Federal Records Act.

The investment-related increases I have just described must be viewed in the context of the overall budget request for the agency. The President's FY 2017 Budget provides $12.3 billion for the IRS, an increase of $878.5 million in investments and an additional $167 million in funding for inflation for a total of $1.045 billion over the FY 2016 level. This amount includes $11.8 billion in base discretionary resources and an additional proposed $514.7 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, which is the difference between taxes owed and taxes paid on a timely basis. This multi-year effort is expected to generate $64 billion in additional revenue over the next ten years at a cost of $18 billion over that 10-year period, thereby reducing the deficit by $46 billion.

Enactment of the program integrity cap adjustment proposal would facilitate funding for several initiatives, including the following:

Additional funding to strengthen enforcement programs: $399 million. This set of initiatives allows for investment to strengthen core enforcement programs to help the IRS improve the resolution of non-compliance with fairness and integrity. Budget cuts over the last several years have led to rising case inventories and call volumes, preventing the IRS from bringing into compliance taxpayers who fail to pay their tax debt, and reducing individual audit coverage to levels below 0.8 percent.

With this additional funding, the IRS will be able to: increase collection and audit coverage; conduct compliance activities related to FATCA; pursue employment tax noncompliance and abusive tax schemes; increase investigations of transnational organized crime; and develop a digital version of the Form 990, *Return of Organization Exempt from Income Tax*.

The investments made through this initiative will, for example allow us to: handle more than 30,000 additional collection cases; close more than 32,000 additional individual audits; expand the Automated Underreporter (AUR) program to process more than 400,000 additional cases; and implement a quality review program for penalty and interest.

Additional funding to maintain the integrity of revenue financial systems: $10 million. The current revenue financial systems do not use commercial software, so the IRS is reliant on internal resources to maintain them. This investment will merge multiple financial systems into one repository to ensure the integrity of the IRS's financial data and make necessary changes to ensure that systems comply with accounting standards and requirements. This will automate reconciliations of the IRS ledger systems and assist in the gathering of data to respond to audits by TIGTA and the Government Accountability Office (GAO). Savings and efficiencies will be achieved in future years through the reduction or elimination of the resources required to maintain the multiple systems supporting operational decision making and the financial audit. This will close a material weakness.

Additional funding for operations and maintenance of deployed Business Systems Modernization (BSM) projects: $92 million. The IRS receives funding for major IT modernization projects through the BSM appropriation, but BSM funds can only be used for developing new systems. Once development is completed, regular operations and maintenance begins, and the IRS is required to pay for this maintenance through its Operations Support appropriation. Since 2013, the IRS has incurred more than $95.5 million in unfunded increased annual requirements to its Operations Support appropriation as a result of BSM systems deployments. The additional funding requested partially restores the Operations Support base so that the funding will not have to be redirected from other areas to pay for the operation of deployed BSM projects. Resources will fund additional staff, hardware and software, and contractual services for these deployed systems.

LEGISLATIVE PROPOSALS TO IMPROVE TAX ADMINISTRATION

The IRS appreciates the actions taken by Congress last year to approve legislation designed to improve tax administration. These measures include: accelerated filing dates for information returns; allowing SSNs to be masked on W2 forms and other information returns; creating a safe harbor for minor errors on information returns; and expanding the due diligence requirements for paid tax return preparers.

The President's FY 2017 Budget contains several additional legislative proposals that would further improve tax administration and enhance IRS operations. They include:

Streamlined critical pay authority. The IRS Restructuring and Reform Act of 1998 increased the IRS's ability to recruit and retain a small number of key executive-level staff by providing the agency with streamlined critical pay authority. This allowed the IRS, with approval from Treasury, to hire well-qualified individuals to fill positions deemed critical to the agency's success in areas such as international tax, IT, cybersecurity, online services and analytics support. This authority, which ran effectively for 14 years, expired at the end of FY 2013. The loss of streamlined critical pay authority has created major challenges to our ability to retain employees with the necessary high-caliber expertise in the areas mentioned above. In fact, there are only 10 IT senior executives and leaders hired under this authority remaining at the IRS and we anticipate there will be no staff left under critical pay authority by next year. The President's FY 2017 Budget proposes reinstating this authority.

Authority to expand the Taxpayer Identification Number (TIN) matching program. The IRS operates a voluntary program under which entities that issue payments subject to backup withholding can confirm with the IRS that the name and TIN of the person receiving the payment match the name and TIN on file with the IRS. Although IRS code section 6103 generally prohibits the IRS from disclosing taxpayer data, the agency is permitted to disclose this information to payors under authority of section 3406. But this authority only covers instances where payments are subject to backup withholding. The proposal would broaden the agency's authority to cover any situation where a person is required to provide the TIN of another person to the IRS.

Correction procedures for specific errors. The IRS has authority in limited circumstances to identify certain computation mistakes or other irregularities on returns and automatically adjust the return for a taxpayer. 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 proposal in the President's Budget that replaces the existing authorities that specify specific tax code amendments with authority to correct specific errors instead. This would allow the IRS to fix errors where the IRS has reliable information that a taxpayer has an error on his/her return. Thus, for example, the IRS could use data from completed state tax return audits to adjust information on the federal return.

Authority to require minimum qualifications for return preparers. The proposal would provide the agency with explicit authority to require all paid preparers to have a minimum knowledge of the tax code. Requiring all paid preparers to keep up with changes in the Code would help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. It would thereby help the IRS to focus resources on the truly fraudulent returns.

Expanded electronic filing requirements for businesses. The proposal would require all corporations and partnerships with $10 million or more in assets to file their tax returns electronically. In addition, regardless of asset size, corporations with more than 10 shareholders and partnerships with more than 10 partners would be required to file electronically. Paid tax return preparers who expect to prepare more than 10 corporate income tax returns or partnership returns annually would be required to file these returns electronically. Additionally, all tax-exempt organizations required to file Form 990 series returns would be required to file electronically.

Chairman Crenshaw, Ranking Member Serrano and Members of the Subcommittee, this concludes my statement. I would be happy to take your questions.