

**WRITTEN TESTIMONY OF
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BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
ON IRS BUDGET AND CURRENT OPERATIONS
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INTRODUCTION

Chairman Graves, Ranking Member Quigley and Members of the Subcommittee, thank you for the opportunity to discuss the IRS's budget and current operations, including efforts to improve taxpayer service.

In allocating resources, the IRS strives to balance three competing and overarching priorities: basic tax administration, sustaining our information technology (IT) systems and modernizing our operations. The President's Fiscal Year (FY) 2019 Budget request attempts to balance these priorities by investing in key mission-critical requirements and build on the work the IRS has already begun in FY 2018 to implement the Tax Cuts and Jobs Act.

This piece of legislation was the first major tax reform legislation in more than 30 years. With hundreds of provisions intended to provide relief to American families and make America's businesses more competitive, the new law will require extensive work by the IRS in calendar years 2018 and 2019 to serve the needs of both taxpayers and tax professionals. We appreciate the additional \$320 million approved by Congress as part of the omnibus budget bill for FY 2018. This funding enables the IRS to start critical implementation activities on time, and we will be transmitting updated implementation plans and two-year cost estimates to Congress in the very near term.

In addition, the IRS has been focused on implementing the tax-related provisions in the Bipartisan Budget Act enacted in early February. Retroactive extension of tax provisions requires the IRS to reprogram its tax return operating systems during the filing season, and by late February the IRS had completed system reprogramming for the three benefits most likely to be claimed on tax returns early in the tax filing season. Since then, the IRS has completed reprogramming its systems, and has updated the necessary forms and instructions, to accommodate the other extender provisions in the Budget Act.

The IRS remains mindful of the need to do everything possible to provide taxpayers and their representatives with secure, high-quality assistance and

services, through every available channel. The agency spends a significant amount of time and resources each year working to fulfill this critical part of our mission, and our workforce remains dedicated to helping taxpayers understand and meet their filing obligations. Taxpayer needs have been evolving, with more taxpayers conducting their business using digital tools at the time and place of their choosing. The FY 2019 Budget invests resources to meet these needs by reducing dependency on a single point of entry and ensuring the IRS meets the needs of all taxpayers.

The most visible service the IRS provides each year is delivery of a smooth tax filing season. I'm pleased to report that the 2018 filing season began on schedule on January 29 and is going well so far. As of March 30, the IRS received more than 94.17 million individual returns. We have issued more than 73.3 million refunds for more than \$212.3 billion, with the average refund totaling approximately \$2,900. As of March 24, our phone level of service (LOS) on our toll-free lines was 78 percent. During Calendar Year (CY) 2017, the IRS received more than 150 million individual income tax returns, 87 percent of which were filed electronically. We issued more than 111 million refunds for a total of approximately \$320 billion, with the average refund totaling approximately \$2,800.

THE PRESIDENT'S FY 2019 BUDGET

The President's FY 2019 Budget request of \$11.135 billion includes savings and reductions of \$24.5 million and more than 2,200 full-time equivalent equivalents (FTE) compared to the FY 2018 enacted level (excluding the one-time funding of \$320 million provided for tax reform in the final bill).

The Budget invests in high-priority programs to allow the IRS to assist more taxpayers by becoming more efficient and effective. The Budget also invests in technology and data analytics, to focus compliance and enforcement contacts on closing the tax gap, and to protect taxpayer refunds from fraud. Importantly, the Budget increases funding for security and replacing obsolete hardware to protect taxpayers' sensitive data from growing cyber threats. In addition, the Budget requests modest changes to the IRS transfer and reprogramming authority to provide the IRS with the flexibility necessary to manage its resources more effectively.

Taxpayer Services. The President's Budget request includes \$2.24 billion for taxpayer services. We will continue our investments in improving the use of online tools and offerings and modernizing the taxpayer experience. The IRS is mindful of the need to continually improve our efforts to ensure taxpayers can file their taxes as quickly and easily as possible. We will continue expanding opportunities for taxpayers and their representatives to complete service and compliance interactions through their preferred channel, be it online, over the

phone, or in-person at one of the IRS's many Taxpayer Assistance Centers (TACs).

Over the last several years the IRS has launched a number of digital applications that allow taxpayers to conduct various transactions online, such as paying their tax bill, having access to certain return information, and requesting an online payment agreement. Our work in this area also includes continuing the development, over time, of online accounts at the IRS where taxpayers can log in securely, obtain the information they need about their account and interact with the IRS as needed.

Effectively serving taxpayers who prefer to be served through electronic channels allows the IRS to reduce costs, increases taxpayer satisfaction and frees up funds to serve those taxpayers who prefer to be served differently. Not only that, efforts to continue improving our online offerings will allow the IRS to simplify return filing for the vast majority of taxpayers. Enhancing taxpayer service in this way will in turn increase voluntary compliance, improve tax administration and increase taxpayer satisfaction.

Operations Support. The President's Budget request includes \$4.16 billion for operations support programs including rent, cyber and physical security, IT services for all IRS employees, and core tax processing and compliance systems. Within that total, \$2.29 billion is allocated for information services.

The management, maintenance, and ongoing enhancement of the IRS's information technology systems are central to the reliability of its operations, and to the successful accomplishment of its mission. The 2019 Budget includes dedicated funding to refresh IRS hardware and software to provide a stable foundation for delivering technology services required for day-to-day operations, transforming the taxpayer experience, and modernizing IRS operations.

At the end of FY 2017, more than 59 percent of IRS hardware was past its useful life compared to 64 percent at the end of FY 2016, and 32 percent of software was two or more releases behind the most current commercially-available version. The FY 2019 Budget provides \$187.8 million to enable the IRS to implement critical hardware and software upgrades and reduce system outages and failures.

Sustained investments in IT are also required to improve cybersecurity and ensure the IRS can continue to safeguard taxpayer data. The IRS combats more than 1 million cyberattacks daily, and operates strong network perimeter defenses to mitigate threats, detect vulnerabilities and monitor network security. The 2019 Budget includes \$303.7 million for these critical activities.

Enforcement. The President's FY 2019 Budget includes \$4.63 billion for enforcement programs, which is \$21.2 million, or 0.5 percent, above the FY 2018

Annualized CR level. In addition, the Budget also includes a program integrity cap adjustment for improving the effectiveness and efficiency of the IRS's overall tax enforcement program.

The IRS remains committed to increasing compliance by assisting taxpayers in fulfilling their tax obligations and enforcing the tax laws. As a result of these efforts, the agency remains one of the most cost-effective investments within the federal government. In FY 2017, the IRS collected \$3.4 trillion in revenue to fund the federal government, which represents more than 90 percent of all federal receipts, and resources invested in the agency lead to significant revenue increases for the nation.

One of the IRS's highest priorities remains the effort to combat tax-related identity theft and refund fraud. Protecting taxpayers and their personal data from identity theft is a critical aspect of taxpayer service, and the IRS has worked to improve its efforts in this critical area. During FY 2017, the IRS continued increasing taxpayer protections to make filing a tax return as safe and secure as possible. As a result, the number of fraudulent refunds declined and the number of taxpayers reporting to the IRS that they were victims of identity theft has also declined. The number of victim reports declined from 401,000 in CY 2016 to 242,000 in 2017, a drop of 40 percent.

Business Systems Modernization. The President's Budget includes \$110 million for business systems modernization, in line with the 2018 enacted level. To gain efficiencies, secure and protect data, and reduce the resources necessary to maintain existing systems, the IRS will continue efforts to modernize its systems. Our main initiatives in this area are: expanding the digital conversion of paper case files, automating repetitive manual processes, leveraging existing data to detect tax noncompliance earlier, and enabling a strong and secure systems platform for taxpayer-facing applications.

IMPLEMENTING THE NEW TAX LAW

Implementing the Tax Cuts and Jobs Act is one of the IRS's highest priorities. The IRS has established a Tax Reform Implementation Office, led by senior leadership, to ensure its successful administration. Preliminary efforts to implement this new law are already underway. For example, the IRS issued two important pieces of guidance related to the new law on December 29, 2017: notices that address amended section 965 of the Internal Revenue Code and the new section 1446(f). Subsequently, the IRS has issued additional guidance relating to section 965, including a set of Frequently Asked Questions that deal primarily with how to report the transition tax.

Additionally, the IRS and the Treasury Department have been working to update the income tax withholding process to take into account changes made by the

new statute that affect virtually every taxpayer who receives a paycheck. In early January, we released updated withholding tables for 2018. In late February we released an updated version of our online Withholding Calculator on IRS.gov, which taxpayers can use to help them ensure the correct amount of tax is being withheld from their paychecks. At the same time, we released a revised Form W-4, *Employee's Withholding Allowance Certificate*, that more fully reflects the new law.

Additional published guidance on the new tax law will be provided as the IRS continues to analyze the law and its impact on tax administration. On February 7, the IRS and the Treasury Department issued a revised Priority Guidance Plan that includes projects related to the law.

Activities to implement tax reform will include: re-programming approximately 140 interrelated return processing systems in conjunction with creating or revising approximately 450 tax forms, publications and instructions; publishing guidance, notices, and Frequently Asked Questions (FAQ); preparing the IRS workforce to help taxpayers understand how the new law applies to them; and importantly, providing taxpayer assistance and outreach.

These estimates reflect one-time costs associated with updating major systems and enabling the IRS to quickly respond to the new tax law changes and anticipated higher taxpayer demand for assistance in 2018 and 2019. As with other major investments, the IRS expects some recurring operations and maintenance costs which will be funded within base appropriations.

LEGISLATIVE PROPOSALS IN THE PRESIDENT'S FY 2019 BUDGET

Along with the funding requested in the President's FY 2019 Budget, we are also asking for Congress's help legislatively, particularly in four important areas that would improve tax administration and support the IRS in fulfilling its mission:

Program Integrity Cap. In addition to the base appropriations request of \$11.135 billion, the FY 2019 Budget proposes a \$362 million program integrity cap adjustment to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS's overall tax enforcement program.

The Budget also proposes a program integrity cap in the outyears to fund new initiatives and inflation. The investments will generate about \$44 billion in additional revenue over 10 years and will cost about \$15 billion for net savings of \$29 billion. Notably, the return on investment (ROI) likely is understated because it does not reflect the effect that enhanced enforcement has on deterring noncompliance.

Streamlined Critical Pay Authority. The IRS Restructuring and Reform Act of 1998 increased the IRS' 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 move quickly 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. Executives hired under this authority included our former Chief Information Officer, a senior cybersecurity expert, our system architect, the director of our online systems development team and other senior IT executives. This authority expired at the end of FY 2013. The last appointment made under Streamlined Critical Pay authority expired on September 29, 2017. Without this authority, the IRS continues to face challenges recruiting and retaining top-level talent, especially IT professionals who can help modernize our IT systems and protect taxpayer data from cyberattacks. The President's FY 2019 Budget request proposes reinstating this authority through FY 2022.

Correction Procedures for Specific Errors. Under current law, 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 a proposal in the President's FY 2019 Budget to provide the IRS with greater flexibility to correct specific errors on taxpayer returns. This proposal would allow the IRS to correct errors in cases when the information provided by the taxpayer does not match the information contained in government databases, or when the taxpayer has exceeded the lifetime limit for claiming a deduction or credit.

Authority to Require Minimum Qualifications for Return Preparers. The President's Budget request proposes providing the Secretary with explicit authority to require that all paid tax return preparers have a minimum knowledge of the Code. This is especially important to ensure that the estimated 400,000 tax preparers without credentials can meet minimum standards for competency. Incompetent and dishonest tax return preparers harm taxpayers by subjecting them to potential audits and by potentially subjecting them to penalties and interest as a result of incorrect returns. Requiring all paid tax preparers to keep up with changes in the Code would help promote high-quality service from preparers, improve voluntary compliance and foster taxpayer confidence in the fairness of the tax system.

Chairman Graves, Ranking Member Quigley and Members of the Subcommittee, that concludes my statement. I would be happy to take your questions.