WRITTEN TESTIMONY OF
DANIEL WERFEL
ACTING COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE OVERSIGHT AND GOVERNMENT REFORM COMMITTEE
ON IRS CONFERENCE SPENDING
JUNE 6, 2013

Introduction

Chairman Issa, Ranking Member Cummings, and Members of the Committee, thank you for the opportunity to appear before you today to discuss the steps that the IRS has taken to implement comprehensive financial controls over meeting and conference approval processes and to dramatically reduce expenses related to travel and training, as well as the 2010 IRS Small Business/Self-Employed Division's Manager Meeting in Anaheim, California. In addition to this topic, as I testified earlier this week,[1] this is obviously a very challenging time for the IRS, in light of the recent inappropriate actions that were brought to light regarding the 501(c)(4) application review process. I look forward to discussing this issue with the Committee as well and ensuring that we are putting in place the appropriate measures to hold individuals accountable, address the processing of such applications, and review the broader internal controls and oversight mechanisms at the IRS.

The 2010 Small Business/Self-Employed Division conference, which was described in the recent report by the Treasury Inspector General for Tax Administration (TIGTA), is an unfortunate vestige from a prior era. While there were legitimate reasons for holding the meeting, many of the expenses associated with it were inappropriate and should not have been incurred. Taxpayers should take comfort in knowing that these kinds of expenses are no longer permitted and such a conference would not take place today. While it continues to be agency practice to periodically conduct training meetings on a national scale, the IRS has dramatically cut the number of meetings involving travel since 2010. Sweeping new spending restrictions have been put in place at the IRS, travel and training expenses have dropped more than 80 percent since 2010, and similar large-scale meetings did not take place in 2011, 2012 or 2013. Under the leadership of the Secretary and Deputy Secretary of the Treasury, the IRS has taken bold steps to ensure travel and conference spending is appropriate, limited, and undergoes a thorough review and approval process.

In addition to the focus of Treasury and IRS leadership on this issue, cutting down on excessive and inappropriate travel has been a personal priority for me. In my previous position as Federal Controller at the Office of Management and Budget (OMB), I led the development and issuance of multiple government-wide policy directives requiring

[1] For your reference, a copy of my June 3 testimony to the House Appropriations Subcommittee on Financial Services and General Government is attached.

Federal agencies to reduce their total amount of spending on administrative expenses, including travel and conferences, as well as putting in place strict policies for the review, approval, and public reporting of conference expenditures.

As the Acting IRS Commissioner, I will do everything possible to ensure that tight spending protocols are in place at the agency to protect the use of taxpayer dollars.

The 2010 IRS Small Business/Self-Employed Division's Manager Meeting

In August 2010, the IRS conducted a three-day leadership and educational meeting for approximately 2,600 managers of the Small Business/Self-Employed (SB/SE) division. This division, which comprises almost one third of all IRS employees, also houses the bulk of IRS compliance staff, and it accounts for the majority of the $50 billion collected in annual IRS enforcement revenue each year. The meeting took place at a time when the IRS needed to ensure that managers had proper training to address significant new programs, major staff turnover and a substantial increase in security threats following the suicide attack on an IRS facility in Austin, Texas earlier in the year that resulted in the tragic death of a member of the SB/SE management team.

Although training remains a vital component of carrying out the mission of the Small Business/Self-Employed Division and other divisions of the IRS, we must make sure to undertake it in the most efficient and cost-effective manner. Unfortunately, that did not occur in this case.

There are several examples of expenditures from the 2010 conference that should not have occurred and would not occur today. One such example involves bringing in paid outside speakers from the private sector. The IRS has concluded that this does not represent an optimal use of taxpayer funds. Accordingly, since the time of the conference the IRS has put in place stringent standards for conferences and training, with the result that paid outside speakers are no longer being used.

Another example is the expense for, and the nature and content of, the videos produced for the conference. Since these videos were produced three years ago, the IRS has put in place tighter procedures to ensure that all of our videos across the agency embrace the core concepts of taxpayer service and employee training in a prudent, cost-effective manner. Videos similar to those shown at the Anaheim conference are not acceptable would not be made today.

IRS Cost-Cutting Actions Since 2010

The IRS takes seriously our obligation to be good stewards of government resources. As detailed below, the agency has instituted a number of procedures over the past three years that ensure sound financial decisions are being made in regard to spending. From Fiscal 2010 through the end of Fiscal 2013, the IRS will have experienced $1 billion in budget cuts and efficiencies. Reducing travel and training costs is a critical part of our cost-savings efforts. We have limited employee travel and training to mission-critical projects. In fact, as the TIGTA report reflects, large meeting-related costs dropped 87 percent between Fiscal 2010 and 2012. This is an ongoing effort, and we continue to examine areas associated with training and travel costs.

Training and Travel

Beginning in FY 2011, the IRS limited employee travel and training to mission-critical projects. Training travel alone has been reduced by $83 million in the last two fiscal years. In addition, the IRS has expanded the use of alternate delivery methods for in-person meetings, training, conference and operational travel. A key component of these cost-saving efforts has been the use of video for training purposes, which is described in more detail below. It has helped us significantly reduce both training costs and training travel costs over the past two fiscal years. We are conducting a review of travel expenses and are considering the potential for further reductions.

Video Savings

The use of appropriate video training and video outreach through the IRS in-house studio has become increasingly important to the IRS to reach both taxpayers and employees. In the current budget environment, using video for training and out-reach purposes helps us save millions of dollars in travel costs and is an important part of successful IRS cost-efficiency efforts. IRS YouTube videos have been viewed more than 6 million times on important issues ranging from refund information to identity theft.

In addition, employee training through videos covers a wide set of key issues, ranging from educating compliance personnel about tax law changes to ensuring that employees respect taxpayer rights. The use of video also helps the IRS hold meetings in a cost-effective manner, through the use of virtual meetings. In one example, we used our in-house studio last year for a virtual town hall available to more than 4,000 IRS managers across the country.

Personnel

Labor is the IRS' largest operating expense, and we have been very focused on managing personnel costs. We have operated under an exception-only hiring freeze since December 2010. In FY 2012, we secured buyout authority that resulted in the elimination of 1,224 positions that did not involve direct service or enforcement interactions with taxpayers. By closely managing hiring and through the use of the buyouts, we reduced the total number of full-time, permanent IRS employees by almost 7,000 between the end of FY 2010 and FY 2012. So far this year, we have further reduced full-time permanent staffing through attrition by another 1,000 full-time employees – thus, we are down 8,000 permanent employees, or approximately 9 percent, since 2010.

Space Optimization

Last year, in an effort to promote more efficient use of the government's real estate assets and to generate savings, 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. These savings will be realized with little or no impact on taxpayer service or enforcement efforts.

Conclusion

The IRS remains committed to being as efficient as possible and spending taxpayer dollars wisely, particularly in the areas of training and travel, but in other areas as well. As we continue to address these areas, I look forward to briefing the committee on the concrete steps we will take to operate more efficiently and effectively.

We will continue to find savings wherever we can, while investing in strategic priorities that allow us to fulfill our dual mission of strong enforcement of the tax laws and excellent customer service. Moreover, we will continue to ensure that the IRS meets its responsibilities to fairly and impartially administer our nation’s tax laws and has the right internal controls and management oversight in place to ensure accountability for doing so. Together, these efforts are essential in restoring the public trust and moving forward with a better, more effective IRS.

Mr. Chairman, Ranking Member Cummings, this concludes my testimony. I would be happy to answer your questions.

Attachment

Testimony of Daniel Werfel to the House Appropriations Subcommittee on Financial Services and General Government, June 3, 2013

WRITTEN TESTIMONY OF
DANIEL WERFEL
ACTING COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITEE ON FINANCIAL SERVICES AND
GENERAL GOVERNMENT
ON IRS OPERATIONS AND FUNDING
JUNE 3, 2013

Introduction

Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the work we are doing to chart a path forward for the IRS.

The mission of the IRS is twofold: to provide America's taxpayers with quality service by helping them understand and meet their tax responsibilities, and to enforce the law with integrity and fairness to all. In order for the IRS to operate effectively, we must have the trust of the American taxpayer. Unfortunately, that trust has been broken as a result of the unacceptable conduct uncovered in the recent report by the Treasury Inspector General for Tax Administration (TIGTA).

Along with the hardworking men and women of the IRS, I am committed to restoring that trust. This begins with moving quickly to take a number of steps: ensuring accountability for the problems that exist in the exempt organizations area, fixing those problems, and conducting a broader review of IRS operations. In taking these steps, we will be guided by several principles. First, we will ensure that we operate with the utmost fairness and impartiality in administering and enforcing the nation's tax laws. Second, we will be as open and transparent as possible with the American people. Third, we will operate in close consultation and cooperation with Congress. Adhering to these principles will ensure that we always act with the best interests of the taxpayers in mind.

The Road Ahead and Restoring Trust

In my first few days at the IRS, I have initiated a comprehensive review of the agency and have taken immediate actions to address the significant and alarming problems identified in the Inspector General's report regarding the 501(c)(4) application process. The TIGTA report makes clear that inappropriate and inequitable criteria were used to help inform determinations of eligibility for 501(c)(4) status, there were inexcusable delays in processing many of these applications, and some organizations were required to furnish unnecessary information in support of their applications. The behavior and actions described in the report are unacceptable, and must be addressed.

The TIGTA report describes a number of factors that led to breakdowns in procedure and oversight within the IRS' exempt organizations area. In particular, there was a series of management oversight failures and a lack of internal controls to ensure the appropriate treatment of applications. Moreover, the staff who handled the applications were not adequately trained, and thus were not well equipped to properly detect political activity and determine if the level of that activity was sufficient to deny an application.

Although additional investigations are underway that will shed further light on this matter, I have, at this time, reached an inescapable conclusion about the behavior described in the TIGTA report. The inappropriate use of certain political labels to determine how applications would be handled resulted in applications being inappropriately singled out for additional scrutiny. Moreover, there was a fundamental failure by IRS management to prevent this inconsistent treatment and ensure that it was halted once management became aware. These failures have undermined the public's trust in the IRS' ability to administer the tax laws in a fair and impartial manner.

I also want to make another important point. I have only been with the IRS a few days, but it is clear to me that IRS employees take great pride in the work they do as non-partisan civil servants dedicated to helping the nation. Like so many, the IRS community is shocked and appalled at the use of political labels inside one part of the organization, and considers it to be an affront to the mission of the IRS and their solemn duty as civil servants to fairly administer our tax laws. This incident has overshadowed the indispensable work the agency and its employees do for the nation every day.

The agency stands ready to confront the problems that occurred, hold accountable those who acted inappropriately, be open about what happened, and permanently fix these problems so that such missteps do not occur again. Moreover, we owe it to the American public to use this moment as an opportunity to take a hard look internally at the IRS and see where other deficiencies or risks may exist, and take action to address them. Our work has already begun in each of these respects, and we will report to the President, the Treasury Secretary and the public by the end of the month about our progress in these efforts.

One of my first actions has been to install new leadership to oversee the exempt organizations area. Last week, I appointed Ken Corbin as the acting director of Exempt Organizations, the unit within the IRS responsible for the review of 501(c)(4) applications, among many other important duties. Most recently, Mr. Corbin was the Deputy Director of Submission Processing for the IRS' Wage and Investment Division. He will report to Michael Julianelle, whom I have asked to serve as acting commissioner of the Tax Exempt and Government Entities Division. Mr. Julianelle has been the director of Enterprise Collection Strategy for the Small Business/Self Employed Division. Both Mr. Julianelle and Mr. Corbin have strong and diverse leadership backgrounds that will help us through this difficult period. I have initiated a search for permanent leadership for the Tax Exempt and Government Entities Division and for Exempt Organizations. I am also conducting a further review to determine what additional personnel actions must be taken to hold individuals accountable and to ensure that we have the proper people in positions of trust.

Another immediate step that must be taken is to address the backlog of applications for 501(c)(4) status, focusing initially on those “potential political cases” referenced in the TIGTA report that are more than 120 days old. Some of these applications are 400 or 500 days old. That is unacceptable. I have directed Mr. Corbin and Mr. Julianelle to submit a plan to me by the end of this week that contains specific milestones for expeditiously resolving this group of cases. I have also made clear that these applications must be examined in a manner consistent with the TIGTA recommendations, so that the reviews, while thorough, are also fair and impartial.

I have further instructed Mr. Corbin and Mr. Julianelle to work expeditiously to ensure that all nine TIGTA recommendations are thoroughly implemented, and I have asked them to provide me with, at a minimum, weekly updates on their progress. I intend to update the public on the status of both the elimination of the existing backlog as referenced above and the implementation of the TIGTA recommendations by posting reports on IRS.gov, and I expect to make my first report by the end of this month.

But the work we are doing extends well beyond Exempt Organizations. I am also reviewing the broad spectrum of IRS operations, processes and practices to focus on how we deliver our mission today and how we can make improvements in the future. In that way, we will develop a better understanding of organizational risks wherever they exist within the IRS. Wherever we find management failures or breakdowns in internal controls, we will move to correct these problems quickly and in a robust manner. As we move forward with our work, we will be transparent about what we learn, our specific plans for improvement, the actions we take and the results achieved.

Of note, as part of our efforts to improve overall risk management at the IRS, I have appointed David Fisher as Senior Advisor and Chief Risk Officer. Mr. Fisher comes from the Government Accountability Office (GAO) where he was the Chief Administrative Officer and Chief Financial Officer. He brings a formidable background in financial management and internal controls, as well as experience leading complex government organizations.

IRS Operations and the Fiscal Year 2014 Budget Proposal

Although there is no question that the IRS is going through a very difficult time, it remains an indispensable organization, filled with dedicated and talented public servants, that is vital to the functioning of government and keeping our economy strong. In Fiscal Year 2012, the IRS collected more than $2.5 trillion in revenue to fund the federal government, approximately 92 percent of all federal receipts. During FY 2012, we processed more than 147 million individual tax returns and issued more than 120 million refunds to taxpayers totaling $333 billion.

Each year, the top priority of the IRS is to deliver a smooth filing season and to make the return filing experience problem-free for the American public. Although taxpayers frequently think of the IRS in terms of enforcement, a consistent point of contact with the IRS for the vast majority of Americans each year involves filing a return and receiving a refund, which last year averaged $3,000 per household.

Aside from managing filing season, the IRS recently has made important progress on a number of strategic initiatives. An excellent example involves our work to improve offshore tax compliance. The IRS has worked to obtain information on owners of offshore accounts and conduct investigations and examinations to bring evaders into the system and to justice. The IRS also made available a special voluntary disclosure program (VDP) in 2009 and again in 2011, and reopened the program in 2012. To date, there have been approximately 38,000 voluntary disclosures from individuals, and the IRS has received back taxes and penalties totaling more than $5.5 billion.

Elsewhere in the enforcement area, last week marked an important milestone as IRS Criminal Investigation participated in a multi-agency effort that led to the indictment of Liberty Reserve for allegedly running a $6 billion money laundering scheme. This is believed to be the largest international money laundering prosecution in history and involved law enforcement actions in 17 countries.

The IRS has also made major strides in the fight against refund fraud and identity theft. So far this year the IRS has suspended or rejected more than 3.9 million questionable returns, and stopped more than 900,000 refunds determined to be fraudulent, worth more than $5.6 billion. Assisting taxpayers victimized by identity theft is also a priority. In 2013 alone, the IRS has worked with identity theft victims to resolve and close more than 350,000 cases.

Along with enforcing the tax laws, the IRS also works to assist taxpayers in meeting their tax obligations. There is no better example of this than the support the IRS has provided in the wake of the recent tornado that devastated parts of Oklahoma. The IRS moved quickly to provide tax relief to tornado victims through actions such as extended return filing and payment deadlines. The IRS provided similar assistance after other recent disasters, including Hurricane Sandy and Hurricane Isaac.

It is important that we continue to make progress on these and other major priorities of the IRS even as we act to address the serious problems that have recently come to light regarding the specific issue of reviewing tax-exempt organizations. It also must be noted that the IRS' recent accomplishments and the critical work it continues to do are set against the backdrop of an extremely tough budget environment.

Since FY 2010 and including the current fiscal year, IRS appropriations have been cut by nearly $1 billion (including more than $600 million in reductions from sequestration and rescissions this year). This represents nearly an 8 percent cut in our annual budget while the total population of individual and business filers grew by more than 4 percent over the same time period. Labor is our largest operating expense, and we have been very focused on managing personnel costs. Through a hiring freeze and limited use of buyout authority last fiscal year, the IRS has reduced the total number of full-time permanent employees by almost 8,000, or about 9%, since 2010. In addition, due to the impact of sequestration on the IRS budget, IRS employees are taking several furlough days before the end of the fiscal year, which will inhibit our overall productivity.

The President's FY 2014 Budget seeks to reverse this downward trend in funding, so that the IRS can continue performing its critical role while sustaining positive results. The president has requested $12.9 billion in direct appropriations for the IRS, an increase of $1 billion over the FY 2012 enacted level of $11.8 billion. The direct appropriation, along with an estimated $110.6 million from reimbursable programs and an additional estimated $277.5 million from user fees, would bring the total operating level to approximately $13.2 billion.

The funds requested for the IRS are vital to allowing the agency to carry out its mission, and continue making progress on important initiatives, including: improving service to taxpayers; increasing our efforts against refund fraud; making our compliance efforts more strategic; using new tools, data, and capabilities to conduct a balanced enforcement program, including improving our use of data received through third-party information reporting; and taking the next steps in building out our e-filing platforms and taxpayer account database. The IRS will also continue to administer tax-related provisions of major legislation, including the Foreign Account Tax Compliance Act (FATCA) and the Affordable Care Act.

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

The President's budget proposal is vital to our efforts to keep tax administration moving forward effectively and efficiently. I also want to stress that it is a top priority for all of the IRS to continue its vital daily operations during this challenging period.

Conclusion

We have a great deal of work ahead of us to review and correct the serious problems that have occurred at the IRS and continue the important work of the agency on behalf of taxpayers. This work is being done every day by thousands of dedicated public servants who remain committed to carrying out the agency's mission. It is an honor for me to serve alongside them. I am confident that, together with Congress and other external stakeholders, we will address the current challenges and move forward with a stronger and more effective IRS.

Mr. Chairman, Ranking Member Serrano, this concludes my testimony. I would be happy to answer your questions.