

**FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2012**

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WEDNESDAY, JUNE 8, 2011

U.S. SENATE,  
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,  
*Washington, DC.*

The subcommittee met at 10:31 a.m., in room SD-138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Moran, and Kirk.

DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

STATEMENT OF HON. DOUGLAS H. SHULMAN, COMMISSIONER

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good morning. I'm pleased to convene this hearing to consider the fiscal year 2012 funding request for the Internal Revenue Service (IRS). It's the largest single account within our subcommittee. Our focus today is on the President's budget request for the IRS. The \$13.6 billion in annual funding constitutes more than half the total amount of discretionary funding under our jurisdiction.

I'm pleased to share the dais with my friend and distinguished Ranking Member, Senator Moran of Kansas, and other Members will probably join us.

Joining us today to present testimony about the resource needs of the IRS is the Honorable Douglas H. Shulman, now in his fourth year of a 5-year term as the 47th Commissioner of the IRS.

Thanks for your service and for accepting the challenge to help lead the IRS from good to great. I welcome the opportunity to conduct a critical oversight of the IRS and its programs through our discussion today.

The Congress exercises its most-effective oversight of agencies and programs through the appropriations process. It allows for an annual check-up and review of operations and spending.

To complement congressional oversight, the IRS has a cadre of important watchdogs and keen observers, including J. Russell George, Treasury Inspector General for Tax Administration; Nina E. Olson, the National Taxpayer Advocate; Paul Cherecwich, Chairman, IRS Oversight Board; the U.S. Government Accountability Of-

office (GAO); and Colleen M. Kelley, National President, National Treasury Employees Union (NTEU). Lots of people are watching. I appreciate the exemplary work and constructive contributions of each of these entities to help us prepare for today's hearing.

The IRS administers the tax laws and collects revenues that fund more than 96 percent of Federal Government operations. Each year the 95,000-plus employees of the IRS make hundreds of millions of contacts with American taxpayers and businesses.

The IRS represents the face of Government to more U.S. citizens than any other agency of Government.

On a budget in this fiscal year of \$12.15 billion, the IRS collected \$2.345 trillion in taxes—93 percent of all Federal receipts. That's \$194 in revenue for every \$1 of appropriated funds given to run this agency. They processed 230 million tax returns, including 141 million individual returns, 7 million corporate, and 30 million employment tax returns. They issued 109.5 million refunds worth \$366 billion, and the list goes on.

For fiscal year 2012, the President's budget request for funding of \$13.2 billion represents an overall increase of \$1.1 billion, or about 9.4 percent more than the fiscal year 2011 level. For the IRS accounts, the fiscal year 2011 enacted bill maintained funding at the same level as provided in fiscal year 2010. I recognize that such a level falls more than \$487 million short of what the President had requested for this year, so there has been belt tightening all around, and it's affected your agency.

#### PREPARED STATEMENT

We will talk today about the budgetary challenges which you face in the upcoming year, some of the policy challenges which drive spending in your agency, and I look forward to hearing more about the challenges the IRS faces in these difficult budgetary times.

[The statements follow:]

#### PREPARED STATEMENT OF SENATOR RICHARD J. DURBIN

Good morning. I am pleased to convene this hearing to consider the fiscal year 2012 funding request of the Internal Revenue Service (IRS), the largest single account within the Senate Appropriations Subcommittee on Financial Services and General Government.

Our focus today is on the President's fiscal year 2012 budget request for the IRS. The \$13.6 billion in annual funding for the IRS alone constitutes just more than half of the total amount of discretionary funding under the jurisdiction of this subcommittee.

I am pleased to share the dais with my distinguished ranking member, Senator Jerry Moran, and other members of the subcommittee.

Joining us today to present testimony about the resource needs of the IRS is the Honorable Douglas Shulman, now in his fourth year of a 5-year term as the 47th Commissioner of the IRS. Thank you for your service and for accepting the challenge to help lead the IRS from "good to great."

I welcome the opportunity today to conduct critical oversight of the IRS and its programs through a candid discussion of where the agency is today, where it needs to be, and how we can ensure that the IRS has the necessary resources to fulfill its important missions.

The Congress probably exercises its most effective oversight of agencies and programs through the appropriations process. It allows an annual check-up and review of operations and spending.

To complement Congressional oversight, the IRS has a cadre of important watchdogs and keen observers monitoring and evaluating its operations. These include the Treasury Inspector General for Tax Administration (TIGTA), the National Taxpayer

Advocate, the IRS Oversight Board, the Government Accountability Office, and the National Treasury Employees Union.

I appreciate the exemplary work and constructive contributions of each of these entities to help critique, guide, promote, and improve the work of the IRS. I invited top officials of each of these organizations to submit written materials to enrich the subcommittee's work and augment the record of these proceedings today.

I ask unanimous consent that the statements and accompanying materials received by the subcommittee be made a part of the permanent record of this hearing.

#### ACCOMPLISHMENTS OF THE IRS

The IRS administers the tax laws and collects the revenues that fund more than 96 percent of Federal Government operations and public services.

Each year, the 95,425 employees of the IRS make hundreds of millions of contacts with American taxpayers and businesses. The IRS represents the face of Government to more U.S. citizens than any other agency.

During fiscal year 2010, the IRS:

- On a budget of \$12.15 billion, collected \$2.345 trillion in taxes—93 percent of all Federal receipts. That's \$194 in revenue for every \$1 in appropriated funds.
- Processed 230 million tax returns, including 141 million individual returns, 7 million corporate returns, and 30 million employment tax returns.
- Issued 109.5 million refunds worth \$366 billion.
- Spent an average of 53 cents to collect each \$100 of tax revenue.
- Examined more than 1.58 million individual income tax returns (an 11 percent increase more than fiscal year 2009) and nearly 30,000 returns filed by corporations.
- More than doubled its offshore presence—adding offices in Asia and Central America, boosting law enforcement staffing throughout the globe, and expanding interaction with international organizations—all designed to investigate and crack down on tax absconders wherever they may be.
- Increased automated under-reporter contact closures to more than 4.3 million—a 19.8 percent increase more than fiscal year 2009—and surpassing the 4 million mark for the first time.
- Provided taxpayer assistance through 305 million visits to the IRS.gov Web site (double the volume in 2004)—responding to the growing demand for electronic tools and online access to information.
- Answered 47 million calls to customer service phone lines.
- Assisted more than 78 million taxpayers through its telephone helpline or at walk-in sites.
- Received 35.1 million automated calls, a 21 percent uptick from fiscal year 2009, reflecting rising demand for self-service options.

#### THE BUDGET REQUEST

For fiscal year 2012, the President's budget requests funding of \$13.284 billion, representing an overall increase of \$1.138 billion, or 9.4 percent, above the fiscal year 2011 enacted level of \$12.146 billion under the continuing resolution enacted on April 15 to cover the balance of this fiscal year.

For the IRS accounts, the fiscal year 2011 enacted bill maintained funding at the same level as provided in the fiscal year 2010 enactment. I recognize that such level falls more than \$487 million short of what the President requested for this year.

While my preference would have been to fund the IRS at the level recommended in our July 2010 Committee-reported bill, I regret to say that we faced a significant reduction in our available discretionary resources.

In fact, our overall allocation cap was 10 percent below the fiscal year 2010 enacted level, compelling some difficult negotiations and funding decisions to finish the fiscal year 2011 bill this spring. I am pleased we were able to avert the troubling \$603 million cut below fiscal year 2010 for the IRS that was included in the House-passed H.R. 1.

The fiscal 2012 funding forecast is, to put it mildly, bleak. This subcommittee faces grim prospects and challenging funding decisions for the ensuing fiscal year, and beyond. It will be helpful to hear Commissioner Shulman's honest appraisal of the resource needs that the IRS will require to achieve its dual mission of:

- Providing America's taxpayers with top quality service by helping them understand and meet their tax responsibilities; and
- Applying the tax law with integrity and fairness to all.

I look forward to hearing more about the particular challenges the IRS faces in these lean budgetary times, and how this subcommittee can be helpful in supporting the mission of the IRS.

Now I'd like to turn the floor over to my colleague, Senator Moran.

STATEMENT OF SENATOR JERRY MORAN

Senator MORAN. Chairman Durbin, thank you. Thanks for the hearing today.

Welcome, Commissioner Shulman.

I understand that the IRS is tasked with enormous responsibilities. The IRS collects the revenue that funds Government and administers our tax laws.

The IRS's goal of improving services, making voluntary compliance easier, and enforcing the laws to ensure that everyone pays their fair share of taxes, is all laudable. I also believe we would all agree that we should make sure that our tax code and the IRS compliance and enforcement efforts don't make it even harder for taxpayers and small businessmen and women to meet their tax obligations.

As we know, the American economy is facing very difficult times, and we need to get the country's economy moving again. Americans are struggling, and overly burdensome regulations and reporting requirements hamper the ability of our Nation's small businesses to grow their businesses and create jobs.

I was very pleased to see the Congress address some of the uncertainty by passing legislation to repeal the costly and unprecedented 1099 tax reporting mandate in the new healthcare law. This marks a significant change in our healthcare law, and that repeal of the 1099 requirement is good news for small business and agriculture producers, who bear the largest burden under these provisions. I am interested in talking to you, Mr. Commissioner, about the consequences of that repeal on your appropriations and budget request.

I note that the President's request for the IRS for fiscal year 2012 is almost \$13.3 billion. This is an approximate \$1.1 billion more than the 2010 enacted level and the fiscal year 2011 level, resulting in a 9 percent increase. Almost half a billion of that increase is requested to begin implementation of the new healthcare law. Given the current fiscal reality, I am interested to learn how the IRS intends to prioritize its goals and carry out its core responsibilities of enforcement and taxpayer services and make progress on important information technology projects.

I appreciate the significant and complex responsibilities that the IRS faces. Given our Government's fiscal constraints, we must carefully review all agency budget requests to ensure taxpayers are receiving the best value for their dollars. We must make sure that we address our country's economic problems in a fiscally responsible way.

Mr. Chairman, I look forward to hearing the testimony, and I thank you for calling the hearing and look forward to working with you on the subjects within this subcommittee's jurisdiction.

Senator DURBIN. Thanks a lot, Senator Moran. And, Mr. Shulman, the floor is yours.

## SUMMARY STATEMENT OF HON. DOUGLAS H. SHULMAN

Mr. SHULMAN. Thank you, Chairman Durbin and Ranking Member Moran. It's good to be here, and I appreciate the opportunity to testify about our 2012 budget.

This budget was crafted during a time of fiscal austerity and belt tightening for the Nation, and it's incumbent upon all of us in Government to be as efficient as possible and to spend taxpayer dollars wisely. This means, in my mind, finding savings where we can, and continuing to invest in strategic priorities that allow us to improve service and voluntary compliance.

The fiscal year 2012 budget includes almost \$190 million in efficiency savings and reductions, and you've got my commitment to continue to look for ways to save the Federal Government money.

Against this backdrop, it's also clear that the IRS is vital to both the functioning of the Government and keeping our Nation and economy strong. In fiscal year 2010, the IRS collected, as the chairman noted, \$2.345 trillion in gross revenues to fund the Federal Government, which is approximately 93 percent of all Federal receipts. For every \$1 spent on the IRS, we collect approximately \$200 of revenue.

Mr. Chairman, one of our core duties, as you noted, is conducting the filing season. Despite late tax law changes, this filing season actually went relatively smoothly. As of the end of May, we had gotten about 133 million individual returns. We issued more than 100 million refunds, totaling \$285 billion. We've also answered more than 50 million taxpayer calls this year.

The IRS e-file program, which is lauded by many as one of the most successful modernization programs in all of Government, continues to show growth. This year, we reached two very major milestones. One is, for the first time ever, we had 100 million people electronically file. And this year—we started the e-file program in 1986—we crossed the 1 billionth electronic filing of a tax return this year. Clearly it's changed the way Americans interact with the IRS.

This is also a big deal for efficiency. It costs us 17 cents to process an electronically filed return. It costs us \$3.66 to process a paper return. And we've been reaping benefits and downsizing our operations ever since e-file started.

Let me also note that we continue to try to help taxpayers who are struggling to regain their footing after the recession. This year, we started something we call our Fresh Start program, which expands our Offer in Compromise Program. It made lien withdrawal easier for taxpayers, it made it easier for small businesses to enter an installment plan, and it changed our lien criteria.

Now, in recognition of the critical role that we play in the economy—both helping taxpayers file their taxes and also collecting the revenue—the President asked for judicious investments in the IRS in the 2012 budget. These investments reflect our balanced approach to both taxpayer service and compliance programs, and our commitment to administer the tax laws in a balanced and fair manner.

It also includes funding to finish, for the 2012 filing season, our key core account database. If and when we've a fully operational

account database, it will mean faster processing of returns, expedited refunds for all Americans, better customer service, and enhanced data security.

I also want to emphasize that, because of our unique revenue collection function, all of the investments in the IRS more than pay for themselves by generating much more revenue than they cost.

Mr. Chairman, I would be remiss if I did not mention for a moment the House budget resolution, which provided a funding level for the Financial Services and General Government Subcommittee of approximately \$2 billion below the fiscal year 2011 enacted level. Because, as you mentioned, we're the majority of the Financial Services and General Government bill, cuts of this magnitude would be substantial and affect all of IRS operations—from answering taxpayer questions on the phone to front-line compliance activities, such as audit coverage.

Because the lost revenues from reduced tax law enforcement, cuts such as those in the House budget resolution would actually increase the deficit by decreasing revenues. In addition, conspicuous drops in our enforcement activities could have an impact on longer-term voluntary compliance in the country.

#### PREPARED STATEMENTS

So let me conclude by just saying, I recognize that we are in a very challenging fiscal environment, and that there's going to be a lot of difficult choices that you and your colleagues are going to need to make. I look very much forward to a constructive dialogue over the weeks and months ahead with this subcommittee, and very much appreciate the support that this subcommittee has given the IRS.

[The statement follows:]

#### PREPARED STATEMENT OF DOUGLAS H. SHULMAN

##### INTRODUCTION AND SUMMARY

Chairman Durbin, Ranking Member Moran, and members of the subcommittee, thank you for the opportunity to appear today to discuss the President's fiscal year 2012 budget request for the Internal Revenue Service (IRS).

This budget was crafted during a time of fiscal austerity and belt tightening for the Nation and it is incumbent upon all of us in Government to be as efficient as possible and spend taxpayer dollars wisely. That means finding savings where we can, and continuing to invest in strategic priorities that allow us to continuously improve.

Against this backdrop, it is clear that the IRS is vital both to the functioning of Government and keeping our Nation and economy strong. In fiscal year 2010, the IRS collected \$2.345 trillion in gross revenue to support the Federal Government, approximately 93 percent of all Federal receipts. Moreover, for fiscal year 2010, we processed more than 140 million individual income tax returns and issued 109.5 million refunds to individual taxpayers totaling \$366 billion.

##### *A Record of Success*

Mr. Chairman, the IRS is also proud of its implementation track record over the past few years.

We have run smooth filing seasons for the last several years, despite new tasks being added to our agenda and late passage of legislation.

We have also made good strides in cracking down on international tax evasion. We struck a landmark deal with the Government of Switzerland, and for the first time received information on thousands of Americans hiding assets in Swiss bank accounts. As we turned up the pressure on those not paying taxes on overseas assets, we had approximately 15,000 voluntary disclosures from individuals who came in under our special Voluntary Disclosure Program (VDP). Since the special pro-

gram closed, we received an additional 4,000 voluntary disclosures from individuals with bank accounts from around the world.

Many of these voluntary disclosure cases involve significant amounts of previously unpaid tax.

However, collecting such substantial additional revenue for past misdeeds is not the only important consideration here. Regardless of dollar size, it is important that we are bringing thousands of U.S. taxpayers back into the system so they properly report and pay their taxes for years to come on their offshore accounts.

In February 2011, the IRS announced a new special voluntary disclosure program designed to help people with undisclosed income from hidden offshore accounts get current with their taxes.

Our goal in our offshore efforts is to fundamentally change the risk calculus of taxpayers. We are well on our way to deterring the next generation of taxpayers from using hidden bank accounts to avoid paying taxes.

We have also been ushering in a new relationship with corporate taxpayers with a major focus on creating forums and venues where we can resolve issues faster and provide more certainty.

The impetus for this new approach stems from the simple shared belief that at the end of the day, taxpayers and tax authorities pretty much want the same thing. They want a balanced tax administration system that provides:

- Certainty regarding a taxpayer's tax obligations sooner rather than later;
- Consistent treatment across taxpayers; and
- An efficient use of Government and taxpayer resources by focusing on the issues and taxpayers that pose the greatest risk of tax noncompliance.

There are several interlocking pieces that will help advance this transformation. It requires more transparency on both sides; a re-tooling of our audit approach; and a commitment to resolving issues quickly and clarifying uncertainty in the law.

We now have a number of innovative, forward-thinking programs and forums, such as our Industry Issue Resolution Program, Compliance Assurance Program, Fast Track Settlement, and our Uncertain Tax Positions reporting requirement that are focused as a package on the goals of faster issue resolution and greater certainty for those taxpayers who want to be transparent.

One of the most important initiatives that the IRS has undertaken in recent memory is the return preparer initiative, which is now being implemented. In September 2010, we launched the new online Preparer Tax Identification Number (PTIN) application system. It is up and running with more than 700,000 preparers already registered in the system.

More than just an identification number, the PTIN registration process gives the IRS an important and better line of sight into the return preparer community than we have ever had before. We can leverage that information to help us better communicate, analyze trends, spot anomalies and potentially detect fraud.

The registration process will help us build in several years a publicly accessible database of preparers who are authorized to prepare returns. This is an extremely important tool for consumers as they will be able to search the database to ensure that their preparer is registered. It will also make it easier to find and track the bad actors out there. They will not be able to pull up stakes and move around anonymously.

The IRS is also very proud of its work in implementing the tax-related provisions of the American Recovery and Reinvestment Act (ARRA) and other economic recovery legislation. We put out billions of dollars to help people buy homes and stabilize the housing market through the First-time Homebuyer Credit, and we added \$400 to \$800 to families' paychecks through the Making Work Pay Credit, just to name two provisions.

The IRS continues to provide taxpayers with quality customer service and different service channels and products. They run the gamut from traditional walk-in sites for those who need to see an IRS representative face-to-face, to toll-free automated and assistor telephone service, to Web-based applications and social media. All make it easier for taxpayers to file and pay their taxes.

Telephone LOS has recovered after several challenging years. This year we are targeting a 71 percent assistor level of service for the full year. Toll-free tax law accuracy and accounts remain respectively at 93 percent and 95 percent, and the overall toll-free customer satisfaction rating stood at 92 percent. Last year, we also saw a 70 percent e-file rate for individuals as compared to a mere 10 percent 15 years ago. As noted in the next section, this translates into a huge savings.

IRS.gov has become the favorite source of information for millions of taxpayers. For fiscal year 2010, there were almost 305 million Web page visits to IRS.gov—a 14 percent increase over the same time period in fiscal year 2009. Use of the

“Where’s My Refund” electronic tracking tool continued to post double-digit yearly gains.

The IRS is increasingly communicating with taxpayers who may not get their information from traditional sources, such as newspapers and broadcast and cable news. By employing social and new media, such as YouTube, Twitter and even iTunes, we are able to reach these taxpayers with important service and compliance messages.

In January 2011, the IRS also unveiled IRS2Go, its first smartphone application that lets taxpayers check on the status of their tax refund and obtain helpful tax information.

This new smartphone app reflects our commitment to modernizing the agency and engaging taxpayers where and when they want.

Finally, the IRS continues to run robust compliance programs. We continue to have appropriate and balanced audit coverage rates across taxpayers and to innovate in our collection programs.

And in our latest effort to help struggling taxpayers, the IRS announced on February 24, 2011, a series of new steps to help people get a fresh start with their tax liabilities.

The goal is to help individuals and small businesses meet their tax obligations, without adding unnecessary burden to taxpayers. Specifically, the IRS set forth new policies and programs to help taxpayers pay back taxes and avoid tax liens.

The announcement centers on the IRS making important changes to its lien filing practices that will lessen the negative impact on taxpayers. The changes include:

- Significantly increasing the dollar threshold when liens are generally issued, resulting in fewer tax liens;
- Making it easier for taxpayers to obtain lien withdrawals after paying a tax bill;
- Withdrawing liens in most cases where a taxpayer enters into a Direct Debit Installment Agreement;
- Creating easier access to Installment Agreements for more struggling small businesses; and
- Expanding a streamlined Offer-in-Compromise Program to cover more taxpayers.

In short, despite a quickly evolving taxpayer base and unprecedented demands on IRS resources, the IRS continues to deliver for the American people.

#### *Working Smarter and Greater Efficiencies*

The IRS continues to reap the financial benefits of the E-File Program, one of the most successful modernization programs in Government. Today we receive nearly 100 million tax returns electronically. In the past these returns had to be opened, sorted, and transcribed manually. The efficiency savings have allowed us to reduce our submission processing sites in half. This year we are closing our 5th of the original 10 sites that processed paper returns.

The fiscal year 2012 budget request includes almost \$190 million in efficiency savings, reductions, and nonrecurring activities. While these targets are substantial, I am confident that we will meet them and more, by finding cost-savings in our operations wherever we can.

I have also challenged the IRS leadership and indeed, all IRS employees, to take a hard look at their operations and look for potential savings and efficiencies.

Even in a tough budget environment, I am confident that the IRS will continue to deliver value for the American taxpayer and will emerge as a stronger agency in the years to come.

I am particularly pleased with the progress that we are making in achieving efficiencies in our technology operations. The IRS has embarked on a multi-year effort to streamline and standardize processes that will allow for substantial efficiency gains. For example, the Information Technology Infrastructure Library is a collection of best practices used to aid in the implementation of a lifecycle framework for IT Service Management. In September 2010, an independent third party found that the IRS recently reached Capability Maturity Model (CMM) Level 2 based on established criteria.

Achieving this level allows standardized project management practices across projects. This will improve our agility and quality in delivering software to our business customers and the taxpaying public, as well as reduce the cost of developing and maintaining products, and improve the cost of engineering services.

#### *Investing in Core Programs*

Indeed, it is in recognition of the critical role that the IRS plays in the economy that the fiscal year 2012 request includes a judicious investment in the IRS’ core service and enforcement programs and initiatives. Enforcement and customer serv-



ice are not an either/or proposition. Accomplishing our mission requires that we do both well.

The request also includes the necessary funding for completing on time for the 2012 filing season the core taxpayer account database. A fully operational customer account database will mean faster processing of returns, expedited refunds for 140 million individual taxpayers and enhanced data security.

The funding in the President's budget request will be used to carry out the IRS' strategic and balanced agenda that includes:

- Improved service to taxpayers, including enhancements to the IRS.gov Web site to meet taxpayer needs and growing demand for more e-services;
- Robust and targeted enforcement programs to address offshore tax evasion and improve tax compliance for corporate and high-income taxpayers;
- Completion of the new taxpayer account database and enhancements to our electronic filing platforms;
- Leveraging the Return Preparer Program to reduce noncompliance;
- Implementation of our Uncertain Tax Position reporting requirements;
- Combating errors and fraud for refundable tax credits, such as the Earned Income Tax Credit (EITC);
- Better use of data, such as credit card and securities basis information reporting;
- Implementation of new tax provisions found in major recent legislation, including the Affordable Care Act (ACA);
- Workforce development to ensure that we have a talented and capable workforce for the foreseeable future; and
- Enhancing workplace/physical security for IRS employees.

The IRS will also administer those portions of ARRA that were extended into 2011. These include the expanded EITC for families with three or more children and the American Opportunity Tax Credit to help pay tuition and other expenses for individuals enrolled in institutions of higher education. In addition, we continue to administer the Health Coverage Tax Credit (HCTC) that was enacted as part of the Trade Adjustment Assistance Reform Act of 2002.

The new enforcement personnel included in the request will generate more than \$1.3 billion in additional annual enforcement revenue once the new hires reach full potential in fiscal year 2014. The roughly \$6 to \$1 return on investment estimate related to these initiatives does not include the indirect revenue effect of the deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact.

#### ACA

The IRS will need to implement and administer the tax provisions of the ACA (Public Law 111-148) in 2012. The IRS seeks to be helpful to families and businesses that will benefit from the ACA. In fact, some benefits have already begun. For example, upon enactment of the ACA, the IRS immediately began to make sure that small employers were aware of a significant new tax credit to help them provide health coverage to their workers.

Because the tax credit was enacted mid-year, and became effective immediately, the IRS conducted a significant outreach campaign to small businesses. In addition to mailing postcards to millions of employers alerting them to the new credit, the IRS held or attended more than 1,000 outreach events targeted at small businesses and the tax practitioners who serve them.

Working with the Department of Health and Human Services, we also administered a program to provide \$1 billion in tax credits and grants to qualifying therapeutic discovery projects.

In addition, we have implemented or have begun to implement changes that expanded the tax credit for adoptive parents, a new exclusion for loan forgiveness programs for certain health professionals, and a new excise tax on indoor tanning services.

We are also working diligently to implement the tax law components of the changes made to the health insurance marketplace that will begin in 2014. Let me put these efforts in context by describing the activities that we are undertaking to plan for these upcoming changes.

The IRS also has significant information technology development work that must be completed in order to administer these provisions. The vast majority of the resources that the IRS will require between now and 2014 will be dedicated to technology and the associated business process design required to effectively administer these new provisions.

#### *Exchanges and Medicaid Health Coverage*

Individuals seeking subsidized coverage will interact with the IRS at a few discrete points in the process:

*Obtaining Coverage Through Exchanges and/or Medicaid.*—The ACA outlines eligibility rules for the premium assistance tax credit, as well as Medicaid. In both cases, the household income as reported to the IRS by approximately 140 million taxpayers on the 2012 tax returns will be relevant to eligibility determination. The IRS will alter its systems to take account of the new concept of household income, and is planning to provide significant educational tools to help individuals understand what household income represents. Furthermore, planning is underway to determine the best way to provide this information to taxpayers via the Web, telephone, and other channels.

*Receiving Advance Premium Tax Credits.*—Individuals who are determined to be eligible for the premium assistance tax credit can receive the benefit through advance monthly payments that are made directly to the plan provider. Working with the Treasury Financial Management Service, which will be making the advanced payment, the IRS will develop new systems for the administration of the tax credit. In addition, the IRS will work with the exchanges as appropriate to ensure there is significant outreach and education to make taxpayers who are receiving the advance payments aware of the importance of reporting mid-year changes in circumstance that could affect their eligibility for, or the amount of the credit.

*Reconciling the Premium Assistance Tax Credit With Advance Payments Made Through the Year.*—The ACA provides that individuals will reconcile the amount of advance payments of the premium credit with the actual amount as computed on the tax return. In other words, advance payments made throughout 2014 will be reconciled with individuals' tax returns that are filed in the spring of 2015. To the extent that the ultimate credit amount is larger than the sum of the advance payments, the additional amount will be added to the taxpayer's refund. If the ultimate credit amount is lower than the sum of the advance credit, the taxpayer will owe additional tax on the return, potentially subject to a cap.

#### *Individual Coverage Requirement*

The IRS will also be responsible for administering the requirement that individuals who can afford health coverage either obtain it or make a payment to the IRS. While implementation of this requirement does not come into effect until 2014, and will appear on the 2014 tax forms that will be filed in the spring of 2015, we have nonetheless received a number of questions about how this provision will be implemented.

First, we anticipate providing significant outreach and education on this provision. This will come directly from the IRS and in partnership with State and Federal agencies, employers, tax return preparers, and others. Our experience in administering new tax laws suggests that the vast majority of individuals will successfully incorporate this provision into their tax year 2014 returns, filed in 2015.

The forms will provide instructions on how individuals can determine if they met the coverage requirement, and if not, how to compute the payment and include it in that year's tax liability. We also plan to work closely with the tax return preparation industry to ensure that the professionals who advise taxpayers are fully informed about this provision. Today, approximately 60 percent of taxpayers use a return preparer and another 25 percent use software to prepare their own returns.

#### *Employer Provisions*

Finally, the IRS will administer the employer responsibility payment for large employers who do not offer affordable coverage, and have at least one employee who receives subsidized coverage through the exchange. This provision closely intersects with the rest of the exchange provisions, and we are working closely with the Department of Health and Human Services and the Department of Labor to reach out to the employer community, understand what questions and issues they foresee, and incorporate the feedback that we get into the up-front program design and regulatory guidance.

#### *Tax Law Changes*

The IRS is also working diligently to implement other tax law changes that come into effect over the next several years. Earlier in my testimony I mentioned several that we are already implementing, and would be happy to answer any questions that you have on those, or the provisions coming into effect in the months and years ahead.

## CONCLUSION

In conclusion, let me thank the subcommittee again for this opportunity to discuss the IRS budget request for fiscal year 2012 which reflects the progress and improvements the IRS continues to make—even in a difficult budget environment.

I believe the fiscal year 2012 budget is fiscally prudent and makes wise investments in strategic priorities in enforcement, service, and business modernization. It will help ensure that the IRS will continue its vital role in keeping our Nation and economy healthy and strong.

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PREPARED STATEMENT OF J. RUSSELL GEORGE, INSPECTOR GENERAL FOR TAX  
ADMINISTRATION, DEPARTMENT OF THE TREASURY

Chairman Durbin, Ranking Member Moran, and members of the subcommittee, I thank you for this opportunity to provide a written statement regarding the fiscal year 2012 budget request for the Internal Revenue Service (IRS).

## OVERVIEW OF THE IRS'S FISCAL YEAR 2012 BUDGET REQUEST

The IRS is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. Since the Federal tax system is a system that relies upon voluntary compliance, almost everything the IRS does in some way relates to fostering compliance with tax laws. The IRS provides taxpayer service programs that help millions of taxpayers to understand and meet their tax obligations and administers enforcement programs aimed at deterring taxpayers who are inclined to evade their responsibilities. The IRS is charged with vigorously pursuing those who violate tax laws.

The IRS must strive to enforce the tax laws fairly and efficiently while balancing service and education to promote voluntary compliance and reduce taxpayer burden. To accomplish these efforts, the proposed fiscal year 2012 IRS budget requested approximately \$13.3 billion<sup>1</sup> in total appropriated resources. The total appropriations amount is an increase of \$1.138 billion, or 9.4 percent, more than the fiscal year 2010 enacted level.

*Program Summary by Appropriation Account*

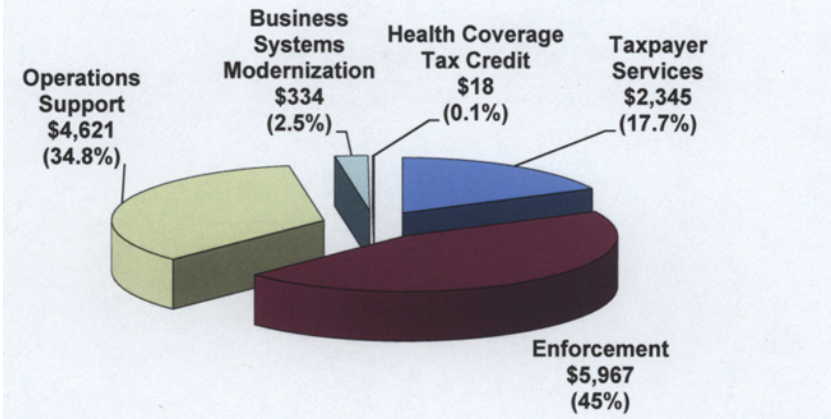
The IRS fiscal year 2012 budget request includes appropriations for five IRS budget accounts, as depicted below:

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<sup>1</sup>The fiscal year 2012 budget request also includes approximately \$138 million from reimbursable programs and \$204 million from user fees for a total operating level of \$13.6 billion.

**IRS Fiscal Year 2012 Budget Request by Appropriation Account  
(in Millions)**

*Note: Percentages total more than 100 percent due to rounding.*



Generally, these five appropriation accounts fund the IRS's tax administration functions. The three primary appropriation accounts are taxpayer services, enforcement, and operations support. The taxpayer services account funds programs that focus on assisting taxpayers with understanding and meeting their tax obligations, while the Enforcement account supports the IRS's examination and collection efforts. The operations support account funds functions essential to the overall operation of the IRS, such as infrastructure and information services. The Business Systems Modernization (BSM) account provides funding for the development of a new taxpayer account database and investments in electronic filing. Finally, the Health Coverage Tax Credit Administration account supports the administration of the Health Coverage Tax Credit.<sup>2</sup>

The administration seeks to increase funding more than fiscal year 2010 enacted operating levels for all of the appropriation accounts, ranging from 3 to 26 percent increases (see chart below). The budget request includes a net increase in IRS staffing of more than 5,100 employees, for a total of more than 100,500 IRS employees.

**IRS FISCAL YEAR 2012 BUDGET REQUEST INCREASE OVER FISCAL YEAR 2010 ENACTED BUDGET**  
[Dollars in thousands]

Appropriation account	Fiscal year 2010 enacted	Fiscal year 2012 request	Dollar change	Percentage increase
Taxpayer services .....	\$2,278,830	\$2,345,133	\$66,303	2.91
Enforcement .....	\$5,504,000	\$5,966,619	\$462,619	8.41
Operations support .....	\$4,083,884	\$4,620,526	\$536,642	13.14
BSM .....	\$263,897	\$333,600	\$69,703	26.41
Health Insurance Tax Credit Administration .....	\$15,512	\$18,029	\$2,517	16.23
<b>Total budget appropriated resources .....</b>	<b>\$12,146,123</b>	<b>\$13,283,907</b>	<b>\$1,137,784</b>	<b>9.37</b>

**IRS Fiscal Year 2012 Priorities**

The IRS will focus efforts on the following priorities in fiscal year 2012 (these priorities are reflected in multiple appropriation accounts):

<sup>2</sup>The Health Coverage Tax Credit is a refundable credit for health insurance available to qualified individuals, enacted as part of the *Trade Adjustment Assistance Reform Act of 2002*, Public Law No. 107-210, 116 Stat. 933 (2002).

*Enforcement.*—A serious challenge confronting the IRS is the tax gap.<sup>3</sup> Despite an estimated voluntary compliance rate of 84 percent and IRS enforcement actions, a significant amount of income remains unreported and unpaid. The IRS estimated the gross tax gap for tax year 2001, the most current figure to date, to be approximately \$345 billion. The IRS's strategy for reducing the tax gap is largely dependent on funding for additional compliance resources as well as legislative changes.

In fiscal year 2012, the IRS will continue to invest in compliance programs, including its relatively newly enhanced international enforcement initiatives to address offshore tax evasion. These initiatives are designed to address the under-reporting of income associated with international financial activities and expand enforcement efforts to address noncompliance by corporate and high-wealth taxpayers and the complex business enterprises they control (including corporations, partnerships, and trusts). The IRS plans to use audit results and intelligence from ongoing offshore initiatives to refine case identification and selection methods to identify promoters, facilitators, and participants in abusive offshore arrangements.

In addition, the IRS will continue to pursue other significant initiatives, such as the Compliance Assurance Process Program, industry issue resolution projects, and fast track settlements, aimed at earlier and speedier issue resolution and greater efficiency. These initiatives are a major part of the overall retooling of the IRS's relationships with large corporate taxpayers.

The IRS also plans to continue to implement the recommendations of the Tax Return Preparer Strategy by addressing the challenges associated with the implementation of registration, continuing education, and testing requirements for tax return preparers that are scheduled to go into effect in fiscal year 2011. The IRS took a major step forward in launching its new Preparer Tax Identification Number online registration process. The process gives the IRS an important and improved line of sight into the return preparer community. The IRS plans to use the information to analyze trends, spot anomalies, and potentially detect fraud. In addition, the IRS will continue to develop and implement legislation to increase the use of electronic filing among the paid preparer community.

*Taxpayer Services.*—Assisting taxpayers with their tax questions before they file their tax returns helps prevent inadvertent noncompliance and reduces the need for the IRS to send burdensome postfiling notices and other correspondence. In fiscal year 2012, the IRS plans to increase its service level by adding resources to meet the ever-increasing demand and by continuing to make efficiency improvements, such as automated self-service applications that allow taxpayers to obtain information on less complicated issues (e.g., refund inquiries). The IRS believes that these improvements will allow staff to address the more complex tax-law issues stemming from the passage of new legislation. In addition, the IRS continues to study the services it offers to taxpayers on the Internet, at walk-in sites, and on its toll-free telephone lines. IRS officials are also exploring the relationships between taxpayer errors and unclear correspondence to guide them in the development of new approaches to service.

*BSM.*—Data and technology are central to the future of tax administration. For the 2012 filing season, the IRS plans to complete the new taxpayer account database and continue to make investments in its electronic filing systems. Completion of the core taxpayer account database is the cornerstone of IRS modernization that is expected to expedite refunds to millions of individual taxpayers. It is also a prerequisite for other major initiatives, such as the expansion of online paperless services. The ability of the IRS to support increasingly complex taxpayer service and compliance initiatives will be severely limited until the new taxpayer account database is completed.

The fiscal year 2012 BSM budget request is \$333.6 million and 453 Full-time Equivalents (FTE).<sup>4</sup> This is an increase of \$69.7 million (26.4 percent) and 120 FTEs more than the fiscal year 2010 enacted level of \$264 million and 333 FTEs. Almost half of the budget request will fund continued development of the Customer Account Data Engine 2 (CADE 2).<sup>5</sup> While the current BSM is in its

<sup>3</sup>The Tax Gap is the difference between the estimated amount taxpayers owed and the amount they voluntarily and timely paid each year.

<sup>4</sup>A measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.

<sup>5</sup>CADE 2 creates a modernized processing and data-centric infrastructure that will enable the IRS to improve the accuracy and speed of individual taxpayer account processing, enhance the

12th year, the IRS's modernization efforts started in the 1980s. The IRS originally estimated that the BSM effort would last up to 15 years and incur contractor costs of approximately \$8 billion. To date, the current BSM has received \$3.24 billion in contractor services, plus an additional \$474 million for internal IRS costs.

The BSM funding is intended to improve taxpayer service and enforcement, and reduce the costs and risks of operating parallel tax processing systems.<sup>6</sup> The IRS plans to update and settle individual taxpayer accounts in 24 to 48 hours with current, complete, and authoritative data which should facilitate expanded opportunities for compliance, increase analytical capabilities, and accelerate the identification of fraudulent trends.

The increases more than the fiscal year 2010 budget seem reasonable considering the investments in developing and rolling out the CADE 2 during fiscal year 2012. Because the IRS is taking more responsibilities for program management, there are more IRS resources and fewer contractor resources devoted to BSM, thus the increase in labor costs. Finally, the other major BSM projects (e.g., Modernized e-File<sup>7</sup>) have reduced budgets for fiscal year 2012 as they are winding down.

In the area of information technology systems operations, the fiscal year 2012 IRS budget request presents several budgetary increases related to maintaining and improving information technology operations and taxpayer service, including \$33 million to expand online options through IRS.gov improvements, \$25 million for portal migration, and \$27.5 million to update the Integrated Financial System.

The portal initiative funds the second year of a 3-year effort to replace the aging infrastructure of the portals and complete the migration of the two portals by August 2013, when the existing contracts expire. This will result in significant enhancements to online capabilities for tax preparers and other registered users. Failure to complete the portal migration by this date will result in increased portal operating costs and increased risk under existing sole-source contracts. In addition, taxpayer and tax practitioners will continue to use more expensive, labor-intensive service delivery channels such as calling the 1-800 telephone number or visiting an IRS taxpayer assistance center.

#### *Implementation of the Affordable Care Act (ACA)*

The implementation of the ACA<sup>8</sup> presents a major challenge to the IRS. The ACA represents the largest set of tax law changes in more than 20 years, with more than 40 provisions that amend the tax laws. Although the new law goes into effect gradually over many years, several provisions required immediate action by the IRS, including the Small Business Health Care Tax Credit, the Qualifying Therapeutic Discovery Credit, and the expanded Adoption Credit. To enact the range of retroactive provisions, the IRS focused on developing new systems and business processes for near-term provisions, conducting initial planning for long-term provisions, and defining appropriate outreach activities for each affected group.

#### ANALYSIS OF THE REQUESTED FISCAL YEAR 2012 BUDGET INCREASE

The fiscal year 2012 budget request of \$13.3 billion for the IRS is a \$1.138 billion (9.4 percent) increase more than the fiscal year 2010 enacted budget. The \$1.138 billion consists of the following:

##### *Changes to the Base*

*Adjustment To Reach Fiscal Year 2011 President's Budget Level*<sup>9</sup>.—Increase of \$402 million, including a \$123 million increase related to the BSM appropriation.

*Maintaining Current Levels*.—Increase of \$86 million.

*Program Reinvestment*.—Increase of \$1.5 million (one-time cost).

customer experience through improved access to account information, and increase the effectiveness and efficiency of agency operations.

<sup>6</sup>The IRS operates parallel tax processing systems that require updates to all systems when tax legislation is changed or updated. These parallel systems include CADE, CADE 2, and the Individual Master File.

<sup>7</sup>The Modernized e-File project develops the modernized, Web-based platform for filing approximately 330 IRS forms electronically, beginning with the U.S. Corporation Income Tax Return (Form 1120), U.S. Income Tax Return for an S Corporation (Form 1120S), and Return of Organization Exempt From Income Tax (Form 990). The project serves to streamline filing processes and reduce the costs associated with a paper-based process.

<sup>8</sup>Public Law No. 111-148, 124 Stat. 119.

<sup>9</sup>The initiatives included in the fiscal year 2011 budget submission are separate from the \$839 million in program increases included in the fiscal year 2012 budget submission.

These increases are offset by a decrease of \$190 million in efficiencies and savings, including a \$1 million decrease related to the modernization appropriation.

#### *Program Changes*

*Program Increases.*—Increase of \$839 million, including an increase of \$52 million in the operations support appropriation for costs related to maintenance of deployed modernization systems. This \$52 million increase is offset by a corresponding decrease of \$52 million in the modernization appropriation for fiscal year 2012.

#### *Adjustment To Reach Fiscal Year 2011 President's Budget Level*

The IRS is requesting about \$402 million to reach the fiscal year 2011 President's budget request adjusted for the proposed pay freeze. The IRS has not issued new guidance for the fiscal year 2012 budget regarding the impact of the full-year fiscal year 2011 continuing resolution signed by the President on April 15, 2011. Therefore, we are presenting the information as reflected in the IRS's fiscal year 2012 budget request dated February 14, 2011.

The fiscal year 2012 budget request does not specify which initiatives are included in the \$402 million increase. However, we reviewed the IRS's fiscal year 2011 budget request, and identified the following program changes in addition to changes to the base:

- \$21 million to increase the telephone level of service;
- \$25 million to improve and redesign the IRS.gov Web site;
- \$247 million to reduce the tax gap. The three largest initiatives associated with this effort are \$121 million for international enforcement to address offshore tax evasion; \$78 million for under-reporting by corporate and high-wealth taxpayers, tax abuse, and other under-reporting issues; and \$38 million to broaden collection coverage;
- \$168 million to complete development of the new taxpayer account database and continue investments in electronic filing systems. This includes continuing development and deployment of BSM projects such as Modernized e-File, core infrastructure (such as portals, hardware, software, and security), and system engineering management capabilities (including project planning and monitoring); and
- \$3 million program reinvestment of a portion of the electronic filing savings to fund the one-time separation costs associated with the September 30, 2011, closure of the Atlanta submission processing site.

Additionally, the IRS identified \$9 million in program reductions to the taxpayer advocate service case processing activities, Low-income Taxpayer Clinic grants, Tax Counseling for the Elderly Program, and Volunteer Income Tax Assistance grants to realign the programs to the fiscal year 2009 enacted levels.

#### *Maintaining Current Levels*

The IRS is requesting about \$86 million to fund nonlabor inflation adjustments and an increase in Federal Employment Retirement System participation. Nonlabor inflation adjustments include rent, postage, supplies, and equipment. No inflation adjustment is requested for pay in fiscal year 2012.

#### *Program Reinvestment*

The increased use of electronic filing has led to the consolidation of sites that process paper individual returns. Resources from electronic filing savings will be reinvested to fund one-time separation costs associated with the September 30, 2011, closure of the Atlanta submission processing site. The IRS fiscal year 2012 budget request includes a net increase of \$1.5 million related to this effort.

#### *Efficiencies and Savings*

The IRS fiscal year 2012 budget request includes a net reduction of about \$190 million related to efficiency savings. This \$190 million reduction represents a total of 523 FTEs. The four largest areas of cost savings are outlined below.

*\$75 Million Decrease From Reduced Information Technology Infrastructure.*—The IRS intends to reduce its infrastructure through the use of the Capability Maturity Model (a process improvement approach that yields efficiencies in software engineering); the use of the Information Technology Infrastructure Library, which will allow the IRS to improve the quality of its information technology services; and further consolidate its security activities to leverage security best practices.

*\$27.3 Million Decrease From Reduced Training, Travel, and Programs.*—The IRS intends to reduce nontechnical training and noncase-related travel, and plans to implement various program efficiencies. The IRS expects to achieve program efficiencies in the BSM, Health Insurance Tax Credit Administration, and various tax-

payer communication and education programs. The IRS also projects this efficiency initiative will lead to a reduction of 41 FTEs.

*\$22.4 Million Decrease From Increased Electronic Filing Savings.*—This decrease results from savings from increased electronic filing. Savings are based on projected growth in electronic filing and continued modernization efforts. As a result of this efficiency initiative, the IRS projects it would need 416 fewer FTEs in submission processing.

*\$22 Million Decrease From Non-recurring Savings.*—These savings would result from the net reduction of nonrecurring, one-time costs associated with various fiscal year 2011 enforcement initiatives (e.g., information technology equipment and training).

#### *Program Increases*

The IRS is requesting an increase of about \$839 million for:

- enforcement initiatives;
- infrastructure initiatives; and
- taxpayer service initiatives.

The largest component of the \$839 million increase is \$606 million related to enforcement initiatives. The \$606 million for the enforcement initiatives includes \$243 million for activities the IRS believes will yield direct measurable results through a return on investment (ROI). The IRS estimates that the activities funded by the \$243 million increase will generate \$1.3 billion annually in additional enforcement revenues in fiscal year 2014. As stated earlier, many of the initiatives affect more than one appropriation account. Additionally, the \$839 million in fiscal year 2012 program increases are in addition to the increases requested for all five appropriation accounts to reach the fiscal year 2011 budget request.

The fiscal year 2012 budget request does not separately align the various program increases to the tax gap; however, many of the initiatives refer to the tax gap. The IRS also states that helping taxpayers understand their obligations under the tax law is critical to improving compliance and addressing the tax gap.

*IRS Enforcement Initiatives.*—\$606 million increase<sup>10</sup> focuses on activities targeted at improving compliance through nine multi-year initiatives. These activities form the backbone of the IRS's approach to address the tax gap.

The five largest enforcement initiatives are summarized below.

*\$260.3 Million To Ensure Accurate Delivery of Tax Credits.*—This initiative calls for 834 new FTEs. The IRS expects this initiative will improve the delivery of existing credits through a combination of improved technology tools and increased enforcement staffing. The initiative also funds the information technology and other systems required to implement the new ACA's Premium Assistance Tax Credit, which becomes effective in 2014. The IRS expects that this initiative will produce additional annual enforcement revenue of \$183.3 million (an ROI of 4 to 1) in fiscal year 2014.

*\$96.7 Million To Increase Coverage To Address Tax Law Changes and Other Compliance Issues (Tax Gap).*—This initiative calls for 497 new FTEs. The IRS anticipates this initiative will address compliance issues and new responsibilities arising from recent tax law changes included in major legislation such as the American Recovery and Reinvestment Act of 2009<sup>11</sup> and the ACA. This initiative will fund compliance programs needed for new provisions such as direct-pay bonds, new requirements on tax-exempt hospitals, a new fee on manufacturers and importers of branded prescription drugs, and the excise tax on indoor tanning. It will also increase audits of specialty programs (i.e., employment tax, excise tax, and estate and gift tax). The IRS believes this initiative will produce additional annual enforcement revenue of \$80.8 million (an ROI of 3 to 1) in fiscal year 2014.

*\$72.6 Million To Increase International Service and Enforcement.*—This initiative calls for 377 new FTEs. The IRS expects it will be able to implement changes required by enactment of the Hiring Incentives to Restore Employment (HIRE) Act of 2010,<sup>12</sup> with funding for this initiative. The IRS will implement the reporting, disclosure, and withholding requirements and expand coverage of international filings; conduct more in-depth international compliance work; strengthen compliance efforts related to offshore activity; and expand the Global High-Wealth Compliance

<sup>10</sup> IRS enforcement initiatives are funded from a variety of appropriations. Therefore, the requested \$606 million increase in enforcement initiatives will not equal the requested \$462 million increase in enforcement appropriations identified on page 3.

<sup>11</sup> Public Law No. 111-5, 123 Stat. 115.

<sup>12</sup> Public Law No. 111-147, 124 Stat. 71.



Group. The IRS predicts that this initiative will produce additional annual enforcement revenue of \$467.1 million (an ROI of 8 to 1) in fiscal year 2014.

*\$58.5 Million To Administer New Statutory Reporting Requirements.*—This initiative calls for 187 new FTEs. Recent legislation established significant new information reporting and sharing requirements from third parties (such as employers and health insurance providers), and the exchanges to administer the ACA's Premium Assistance Tax Credit, the individual coverage requirement, and the employer responsibility payment. Effective implementation requires significant enhancements to existing information returns systems to handle the additional volumes and new information reporting categories. This initiative also includes resources to implement provisions that allow the IRS to share tax data with State and Federal entities to determine eligibility for the credit and to ensure the secure exchange of information.

*\$52 Million To Increase Collection Coverage.*—This initiative calls for 413 new FTEs. The IRS expects this initiative will expand work on the collection inventory and improve collection processes to bring taxpayers who fail to pay their debt into compliance and produce additional annual enforcement revenue of \$398.3 million (an ROI of 9 to 1) in fiscal year 2014.

*Infrastructure Initiatives.*—\$119 million increase focuses on enhancing employee security, developing disaster recovery system capability, and establishing systems to implement various provisions of the ACA through four initiatives. The three largest initiatives are summarized below.

*\$62.5 Million To Implement Individual Coverage Requirement and Employer Responsibility Payments.*—This IRS initiative supports the development of information technology, infrastructure, and systems to implement the provisions of the ACA that establish shared responsibility payments for both individuals and employers. The IRS requested an additional 65 FTEs for this program initiative. Beginning in 2014, the ACA requires individuals who are able to afford health insurance to obtain minimum essential coverage or pay a penalty. If affordable coverage is not available, certain individuals may be eligible for an exemption.

*\$27.5 Million To Update the Integrated Financial System (IFS).*—The IRS believes updating the IFS will ensure compliance with future Federal accounting requirements; eliminate current work-around processes necessary to support adjustments and reimbursable receivables activities not provided in the current system; eliminate the year-end blackout period and multiple budget versions; and eliminate the month-end accrual process because liabilities would post upon receipt. This initiative calls for five new FTEs.

*\$15.5 Million To Enhance Physical Security for Federal Employees.*—The February 2010 attack against the Austin, Texas, IRS office killed one IRS employee and injured several others. As a result of this attack, this initiative will provide the investments needed to update and/or upgrade the physical security of IRS facilities. The investments are designed to enhance the overall security of IRS employees in the workplace. This initiative calls for 10 new FTEs.

*Taxpayer Services Initiatives.*—\$114 million increase focuses on improving taxpayer service and the IRS.gov Web site through two initiatives as summarized below.

*\$81.3 Million To Improve Taxpayer Service.*—The IRS expects this initiative and the \$25.9 million increase requested for fiscal year 2011 will provide additional staffing of at least 519 FTEs to address rising demand and increase the customer service representative level of service from the planned target of 71 percent in fiscal year 2010 to 80 percent in fiscal year 2012, while maintaining a 93 percent customer satisfaction rate for toll-free telephone services. This initiative also includes funding to help taxpayers understand the new tax law provisions and to make related call center and infrastructure changes to handle anticipated inquiries, including questions regarding the ACA.

*\$33 Million To Expand Online Options Through IRS.gov Improvements.*—This IRS initiative will continue the multi-year effort to replace the outdated web portal environment and provide additional online services to taxpayers. This initiative will allow the IRS to continue the replacement of an outdated web portal environment that has reached the end of its useful life with the help of 15 additional FTEs.

Chairman Durbin, Ranking Member Moran, and members of the subcommittee, I thank you for the opportunity to provide this statement regarding the fiscal year 2012 budget request for the IRS.

PREPARED STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE,  
DEPARTMENT OF THE TREASURY

Chairman Durbin, Ranking Member Moran, and distinguished members of this subcommittee: Thank you for inviting me to submit this written statement regarding the proposed budget of the Internal Revenue Service (IRS) for fiscal year 2012.<sup>1</sup> As the National Taxpayer Advocate, the statutory voice for taxpayers and taxpayer rights inside the IRS, I submit the following thoughts for your consideration:

- The IRS requires additional funding to collect the revenue that supports the Federal Government and to better meet the service needs of the taxpaying public.
- The IRS, in particular, requires more funding to improve taxpayer services. Both the quality of taxpayer services, like answering taxpayer phone calls and responding to correspondence, and the quantity of taxpayer outreach and education have diminished in recent years. At this point, only 5 percent of the IRS budget is allocated for pre-filing taxpayer assistance and education. In addition, the combination of increased IRS enforcement actions and the recession has created substantially greater taxpayer need for assistance from the Taxpayer Advocate Service (TAS) and the Low Income Taxpayer Clinic Program.
- The existing IRS budget structure does not accurately portray the activities of the IRS. In particular, a significant percentage, and perhaps the majority, of funding included in the “taxpayer services” account is not spent on programs commonly viewed as taxpayer service.
- The “program integrity allocation adjustment” mechanism has been used in a manner that enables the IRS to receive extra funding for enforcement but not for its taxpayer service activities. Under the proposed fiscal year 2012 budget, the IRS would receive an additional \$936 million in enforcement funding through this mechanism (which amounts to 16 percent of the \$5,966,619,000 enforcement total), while receiving \$0 in additional taxpayer-service funding through this mechanism.<sup>2</sup> This is true despite the fact that taxpayer service indisputably plays a significant role in promoting tax compliance.
- The IRS desperately needs to conduct or commission better research so it can allocate its service and enforcement resources more efficiently.
- The IRS should revise its mission statement to acknowledge explicitly that its traditional role as the tax collector has expanded in recent years so that it is now both—
  - collecting taxes; and
  - administering social and economic benefits programs.

This dual role should also be recognized explicitly in the budget to ensure the IRS receives sufficient funding to staff and perform both roles effectively.

Before I delve into these issues, I want to take a moment to acknowledge the extraordinary work of the IRS workforce and its leadership. In fiscal year 2010, the IRS collected more than \$2.3 trillion to support the financial commitments of the Federal Government.<sup>3</sup> It processed about 2.7 billion information returns<sup>4</sup> and about 230 million tax returns, including 141 million individual returns, 7 million corporation returns, and 30 million employment tax returns.<sup>5</sup> Customer service representatives answered 47 million calls,<sup>6</sup> and IRS enforcement personnel ramped up examination and collection activities.<sup>7</sup> At the same time, the IRS launched major initiatives to regulate Federal tax return preparers and combat noncompliance by taxpayers utilizing offshore bank accounts. There are always tasks the IRS could perform better—and I will address some of them below—but I think it is important to

<sup>1</sup>The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

<sup>2</sup>IRS FY 2012 Budget Request, *Congressional Budget Submission 77* (Feb. 14, 2011), available at [http://www.treasury.gov/about/budget-performance/Documents/CJ\\_FY2012\\_IRS\\_508.pdf](http://www.treasury.gov/about/budget-performance/Documents/CJ_FY2012_IRS_508.pdf).

<sup>3</sup>IRS Data Book, FY 2010, Table 1.

<sup>4</sup>*Id.* at Table 14.

<sup>5</sup>*Id.* at Table 2.

<sup>6</sup>IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending September 30, 2010).

<sup>7</sup>See IRS FY 2010 Enforcement Results, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf).

place these comments in context by acknowledging how much the IRS does very well.

THE IRS REQUIRES ADDITIONAL FUNDING TO MAXIMIZE THE COLLECTION OF TAX REVENUE AND TO BETTER MEET THE SERVICE NEEDS OF THE TAXPAYING PUBLIC

As I have testified previously, I view the IRS as the accounts receivable department of the Federal Government. If the Federal Government were a private company, its management would fund the accounts receivable department at whatever level it believed would maximize the company's bottom line. Since the IRS is not a private company, maximizing the bottom line is not—in and of itself—an appropriate goal. But the public sector analogue should be to maximize tax compliance, especially voluntary compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden. Studies show that if the IRS were given more resources, it could collect substantially more revenue.

In my 2006 Annual Report to Congress, I recommended that the Congress provide the IRS with after-inflation increases of about 2 percent to 3 percent a year for the foreseeable future. I continue to believe that increasing the IRS budget at this rate is an excellent financial investment.

Most Federal expenditure programs are just that—expenditure programs. The funds are intended to be spent on worthwhile programs, but the expenditures generally do not directly generate more Federal revenue. The IRS is different. The IRS collects well more than 90 percent of all Federal revenue.<sup>8</sup> On a budget of about \$12.1 billion,<sup>9</sup> the IRS collected about \$2.35 trillion in fiscal year 2010.<sup>10</sup> In other words, every \$1 appropriated for the IRS produced about \$194 in Federal revenue.

In evaluating the likely revenue benefits of additional funding, the average return on investment (ROI) of 194:1 is less important than the marginal ROI that can be achieved for each additional \$1 spent. While the marginal ROI is considerably less than 194:1 and will differ by program, studies generally show that, within reasonable limits, each additional \$1 appropriated to the IRS generates substantially more than an additional \$1 in Federal revenue, assuming the funding is wisely spent. (As I discuss below, however, the IRS needs to develop improved methods to measure the ROI of its activities.)

Because of our national fiscal challenges, there has been considerable discussion recently about freezing or reducing all domestic discretionary spending. In my view, the IRS as the tax collector should be exempt from any such freeze or reduction. Reducing funding for the IRS will almost surely increase the deficit, because the reduction in revenue collected by the IRS will exceed the reduction in funding. A decision by the Congress to address our budget problem by cutting IRS funding would be akin to a private business attempting to address a spending shortfall by cutting its Accounts receivable department. In other words, it would be penny-wise, but pound-foolish.

*Recommendation*

In light of the IRS's unique role as the Federal revenue collector, I recommend that the Congress develop new budget procedures to ensure that the IRS is funded at whatever level will maximize tax compliance, with due regard for protecting taxpayer rights and minimizing taxpayer burden. Over the long term, this approach may include exempting the IRS from spending ceilings or even taking the IRS off-budget. In the short run, this approach should include carving out the IRS from discretionary budget freezes intended to reduce the deficit, as cuts to the IRS budget are likely to increase the deficit.

THE IRS ESPECIALLY REQUIRES MORE FUNDING TO IMPROVE TAXPAYER SERVICES

The IRS's fiscal year 2005–fiscal year 2009 strategic plan was based on the slogan, “Service + Enforcement = Compliance,” and the IRS in fiscal year 2006 proposed to restructure its budget so that the two principal categories would be “taxpayer services” and “enforcement.” In both cases, service is listed before enforcement. Although we view this formula as simplistic,<sup>11</sup> it reflects the indisputable

<sup>8</sup> See IRS Fact Sheet, FS–2011–09, *IRS FY 2012 Budget Proposal Summary* (February 2011), available at <http://www.irs.gov/newsroom/article/0,id=235959,00.html>.

<sup>9</sup> Department of the Treasury, *FY 2012 Budget in Brief* (showing fiscal year 2010 enacted levels).

<sup>10</sup> Government Accountability Office, GAO–11–142, *Financial Audit: IRS's Fiscal Years 2010 and 2009 Financial Statements* at 59 (Nov. 2010).

<sup>11</sup> See, e.g., *Internal Revenue Service FY 2008 Budget Request: Hearing Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations*, 110th Cong.

premise that both taxpayer service and enforcement contribute to tax compliance. Despite the intended implication that there is some rough equivalence between taxpayer service and enforcement in bringing about tax compliance, however, there is no equivalence in the IRS budget.

For fiscal year 2012, the proposed budget would spend \$701 million on “Pre-filing Taxpayer Assistance and Education,” which is what most taxpayers think of as taxpayer service. This amounts to only 5 percent of the IRS budget. The last few years have been particularly challenging for the IRS and many taxpayers, as the recently enacted Economic Stimulus Payments, First-Time Homebuyer Credits, and Making Work Pay Credits, among other tax benefits, have proven complex to claim or substantiate and have led to a significant increase in taxpayer inquiries and problems. As I will describe below, the IRS has been unable to keep up with taxpayer needs.

Significantly, the IRS has been ramping up spending for enforcement programs in recent years while holding taxpayer-service spending flat. If the proposed fiscal year 2012 budget is adopted without change, spending for the enforcement account will have increased by 15.4 percent while spending for the taxpayer services account will have declined by 0.3 percent since fiscal year 2006 on an inflation-adjusted basis.<sup>12</sup>

Not surprisingly, key IRS performance measures have improved for enforcement, but declined for taxpayer service. For example, the IRS’s fiscal year 2010 Management Discussion and Analysis included in the GAO’s financial audit of the IRS states: “Collection related to enforcement activities totaled \$57.6 billion, a 34 percent increase over fiscal year 2004.”<sup>13</sup> By contrast, I note that the IRS answered 74 percent of all calls from taxpayers seeking to speak with a telephone assister in fiscal year 2010 as compared with 87 percent in fiscal year 2004, a decline of 13 percentage points, or 15 percent.<sup>14</sup> The IRS’s ability to timely process taxpayer correspondence has also declined. Comparing the final week of fiscal year 2004 with the final week of fiscal year 2010, the backlog of taxpayer correspondence in the tax adjustments inventory has jumped by 76 percent (from 357,151 to 628,016), the percentage of “uncontrolled” correspondence received, but not yet entered into IRS computer systems has increased by 134 percent (from 8.3 percent to 19.4 percent of correspondence), and the percentage of taxpayer correspondence classified as “overage” has increased by 135 percent (from 11.5 percent to 27 percent).<sup>15</sup>

*Taxpayer Service Contributes to Higher Rates of Tax Compliance, and Outreach and Education in Particular Should be Increased*

Despite general agreement that both service and enforcement contribute to greater tax compliance, policymakers seeking to improve compliance and close the tax gap tend to focus almost exclusively on new enforcement measures—more audits, more collection actions, and more third-party information reporting to facilitate data-matching. The central role that service plays in promoting tax compliance is all too often overlooked.

At the most basic level, there would be no compliance if the IRS did not publish forms and publications, provide instructions on how to file returns, and answer filing-related questions. However, taxpayer service goes beyond merely publishing forms and answering telephone calls.

Taxpayer outreach and education are critically important to achieving voluntary tax compliance, which is the cheapest type of compliance for the government. In my view, the IRS is not conducting nearly enough outreach and education to taxpayers, especially self-employed and small business taxpayers, to maximize voluntary compliance. According to the IRS’s most recent estimate of unpaid taxes, \$148 billion,

(2007) (statement of Nina E. Olson, National Taxpayer Advocate); *Internal Revenue Service FY 2006 Budget Request: Hearing Before the Subcomm. on Transportation, Treasury, the Judiciary, Housing and Urban Development, and Related Agencies of the S. Comm. on Appropriations*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

<sup>12</sup> Compare Department of the Treasury, *FY 2012 Budget-in-Brief* with Department of the Treasury, *FY 2008 Budget-in-Brief*. (The FY 2006 budget was adopted using a different budget structure. The proposed FY 2008 budget shows the enacted FY 2006 totals as translated into the current budget structure.) Inflation adjustments were made using the Bureau of Labor Statistics inflation calculator, available at <http://data.bls.gov/cgi-bin/epicalc.pl>.

<sup>13</sup> Government Accountability Office, GAO–11–142, *Financial Audit: IRS’s Fiscal Years 2010 and 2009 Financial Statements* at 23 (Nov. 2010).

<sup>14</sup> See IRS FY 2010 Enforcement Results, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf).

<sup>15</sup> Compare IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2010) with IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 25, 2004).

or 43 percent of the aggregate tax gap, is attributable to unreported income earned by unincorporated businesses and the associated unpaid self-employment tax.<sup>16</sup>

To be sure, a portion of the small business tax gap reflects a willful failure to report income. However, another portion reflects lack of knowledge about how to comply. For example, consider an individual without a college degree who becomes a successful plumber or electrician with a growing customer base. If he hires employees, he will face a host of employment, immigration verification, and local, State and Federal tax requirements, including the need to withhold and pay over payroll taxes with respect to his employees and to file employment tax and income tax returns on behalf of his business. Moreover, he likely will need to grapple with complex rules such as those dealing with automobile and transportation expenses, inventory, and depreciation of equipment and other fixed assets. For most taxpayers, these requirements would seem daunting or even impenetrable, and some taxpayers inevitably do not comply simply because they have no idea where to begin.

The IRS's current compliance strategy, which consists largely of posting general information on its Web site and auditing a tiny fraction of small business returns,<sup>17</sup> can be improved. The IRS can increase compliance in the small business community efficiently if it expands its outreach and education efforts through a more robust field function and commits more resources to meeting proactively with small businesses that are starting operations.

In fiscal year 2006, the Appropriations Committees of the House and the Senate directed the IRS, the IRS Oversight Board, and the National Taxpayer Advocate to collaboratively develop a 5-year strategic plan for taxpayer service.<sup>18</sup> In response, the IRS developed a plan known as the Taxpayer Assistance Blueprint (TAB). The IRS conducted extensive research on the needs and preferences of individual taxpayers in the course of developing the TAB. Pursuant to annual appropriations directives, the IRS is continuing to provide the Appropriations Committees with annual progress reports.

As I have recommended before—and as the Appropriations Committees urged 2 years ago<sup>19</sup>—the IRS should expand the scope of its TAB research studies to include self-employed and small business taxpayers and then should apply the knowledge it acquires through the studies to all of its interactions with those taxpayers. The IRS should also expand its outreach to tax-exempt organizations to improve compliance in that sector.

*Taxpayer Services Should Be Strengthened To Meet the Service Needs of U.S. Taxpayers.*

Beyond compliance, I believe the IRS has an obligation to provide high-quality service to its taxpayers simply as a matter of good government. When we ask people to pay over a large percentage of their income to the Government each year, the least we can do is make the process as simple and painless as possible.

In important respects, IRS taxpayer service is falling short. Consider the following four examples:

*Telephone Service.*—Each year, tens of millions of taxpayers call the IRS seeking help with a wide variety of issues, including account questions and tax-filing questions. Yet the IRS is unable to answer a large percentage of these telephone calls. The Customer Account Services (CAS) Customer Service Representative Level of Service (LOS), generally measures the percentage of calls that get through to a representative among all callers seeking to do so. By this measure, as noted, the IRS answered 87 percent of its calls in fiscal year 2004. Since that time, the LOS has been declining, plummeting to a low of 53 percent in fiscal year 2008. In other words, IRS telephone assistants in fiscal year 2008 were unable to answer nearly one-half of the calls they received.

<sup>16</sup> See IRS News Release, IR-2006-28, *IRS Updates Tax Gap Estimates* (February 14, 2006) (accompanying slide 1), available at <http://www.irs.gov/newsroom/article/0,,id=154496,00.html>.

<sup>17</sup> In fiscal year 2010, the IRS audited 0.58 percent of all business returns, including 0.94 percent of small C corporations (under \$10 million in assets), 0.37 percent of Subchapter S returns, and 0.36 percent of partnership returns. See IRS fiscal year 2010 Enforcement Results, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf).

<sup>18</sup> H.R. Rep. No. 109-307, at 209 (2005) (Conf. Rep.).

<sup>19</sup> The House report “urge[d] the IRS to continue to expand upon its TAB-related work with regard to small business and self-employed taxpayers and tax-exempt and government entities, and to include these additional categories in the annual IRS update to the TAB.” H.R. Rep. No. 111-202, at 21-22 (2009). The Joint Explanatory Statement of Managers accompanying the conference report made clear that the House language was approved by the conference committee. H.R. Rep. No. 111-366, at 892 (2009) (Conf. Rep.).

In fiscal year 2010, the LOS rebounded somewhat to about 74 percent, and it is running at about that level so far in fiscal year 2011.<sup>20</sup>

While answering 74 percent of calls is a vast improvement over 53 percent, it means the IRS is still failing to answer 1 out of every 4 calls it receives from taxpayers who need assistance. Equally concerning, among calls that do get answered, the average wait time in fiscal year 2010 was nearly 11 minutes,<sup>21</sup> up from about 4½ minutes in fiscal year 2007.<sup>22</sup>

Although hard to quantify, the impact of the IRS's inability to answer taxpayer calls is significant and has considerable downstream consequences:

- When taxpayers call the toll-free line with tax law questions and cannot get through, some will just give up and not bother to file their tax returns. Others will file inaccurate returns that require IRS follow-up action and taxpayer response.
- When taxpayers receive notices proposing additional tax, many have questions and try to reach the IRS by phone. If they cannot get through, they remain unsure about what to do and some will not respond, requiring the IRS to take further steps and potentially exposing those taxpayers to enforced collection action. Others will write letters to the IRS, requiring IRS employees in the AM function to respond.

In his book, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America*, former Commissioner Charles Rossotti addressed the importance of maintaining a high level of service on the IRS's toll-free lines:

“Apart from the justifiable outrage it causes among honest taxpayers, I have never understood why anyone would think it is good business to fail to answer a phone call from someone who owed you money.”<sup>23</sup>

Let me be clear that I am not being critical of the IRS's handling of the increased telephone volume—it generally is applying its current resources appropriately and is seeking new ways to use those resources more productively. However, to meet taxpayers' needs, to improve taxpayers' ability to comply with the law and respond to IRS notices, and to reduce the aggregate burden on the IRS when those who cannot get through by phone contact the IRS through multiple channels with the same question, I believe the IRS must be able to answer at least 85 percent of taxpayer calls and keep taxpayers on hold for no longer than an average of 5 minutes.<sup>24</sup>

*Taxpayer Correspondence.*—The IRS's responsiveness to taxpayer correspondence is also lagging. Some AM employees shuttle back and forth between working with paper correspondence (including the processing of amended returns) and answering telephone calls. When IRS employees dedicated exclusively to answering taxpayer calls cannot handle the volumes, AM employees are shifted from handling paper correspondence to help out. Not surprisingly, as call volumes have increased and AM employees have been moved to answer telephone calls, paper correspondence inventories have increased as well. The correspondence inventory rose from approximately 480,000 at the end of fiscal year 2007 to approximately 628,000 at the end of fiscal year 2010—a 31 percent increase.<sup>25</sup>

To some degree, the combination of poor telephone service and slow correspondence processing creates a vicious cycle: Taxpayers who cannot get through to the IRS by telephone send letters, causing more work for employees assigned to paper correspondence and leading to correspondence backlogs and delays in processing amended returns, while taxpayers who write to the IRS and do not receive timely responses call the IRS to try to figure out what happened. The IRS requires taxpayers to file their returns and respond to notices

<sup>20</sup>See IRS FY 2010 Enforcement Results, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf); IRS, Joint Operations Center, *Snapshot Reports: Customer Account Services—CAS* (week ending May 21, 2011).

<sup>21</sup>IRS, Joint Operations Center, *Snapshot Reports: Customer Account Services—CAS* (week ending September 30, 2010).

<sup>22</sup>IRS, Joint Operations Center, *Snapshot Reports: Customer Account Services—CAS* (week ending September 30, 2007).

<sup>23</sup>Charles O. Rossotti, *Many Unhappy Returns: One Man's Quest to Turn Around the Most Unpopular Organization in America* 285 (2005).

<sup>24</sup>For a more detailed discussion of the IRS's toll-free telephone service, see National Taxpayer Advocate 2009 Annual Report to Congress 4–16 (Most Serious Problem: *IRS Toll-Free Telephone Service Is Declining as Taxpayer Demand for Telephone Service Is Increasing*).

<sup>25</sup>IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (weeks ending Sept. 29, 2007 and Sept. 25, 2010, respectively).

on a timely basis. Taxpayers have a right to expect comparable timeliness of the IRS.

*TAS.*—The workload facing my own organization, the TAS, has increased substantially in recent years. Although the TAS has other important responsibilities, we are primarily the case-working operation of the IRS for taxpayers who are experiencing a significant hardship. We assist taxpayers who are experiencing a current or imminent financial hardship as a result of an IRS action or inaction (e.g., where an IRS levy against a taxpayer’s paycheck will lead to eviction or a shutoff of utilities) or who are experiencing a systemic hardship because the IRS has not served them on a timely or accurate basis (e.g., where the IRS has failed to issue a refund or process a taxpayer’s response to an audit or collection notice). By statute, the Congress has required that the TAS make at least one advocate available for each State,<sup>26</sup> and we currently have 74 offices that serve taxpayers. Many of you are familiar with our local taxpayer advocates, because TAS handles congressionally referred taxpayer cases as well.

TAS’s annual case receipts rose from 168,856 in fiscal year 2004 to 298,933 in fiscal year 2010—an increase of 77 percent. For the first half of fiscal year 2011, the TAS case receipts have risen by an additional 4.3 percent as compared with the first half of fiscal year 2010. There are two main drivers of this increase. First, the majority of the TAS’s cases stems from IRS compliance actions, and the IRS has substantially increased the number of these actions in recent years.<sup>27</sup> Second, the TAS receives more cases during economic downturns, when more taxpayers cannot pay their tax bills and get into trouble with the IRS.

To date, the TAS has managed to handle the increased caseload. After several years of declining staffing, the TAS has been able to hire three new categories of employees over the past few years to assist our case advocates in doing their jobs. We now have 116 “intake advocates,” who answer telephone calls, respond to simple taxpayer questions, and assist with case-building by identifying key facts and issues and requesting necessary documentation. We also have 127 “lead case advocates,” who mentor and assist case advocates with unusually challenging cases, maintain partial caseloads of their own, and help develop the TAS best practices. Finally, we have 18 “campus technical advisors,” who provide technical guidance and support on complex cases worked by the IRS in each of its 10 campuses. These additional specialty positions have freed up our case advocates to spend more direct time resolving taxpayer cases and have given them helpful resources when they get stuck on technical issues. The TAS management has also taken steps to improve efficiencies.<sup>28</sup>

As a result of these measures, I am pleased to report that the TAS has continued to perform well. In fiscal year 2010, the TAS obtained full relief for taxpayers in 69 percent of our cases and partial relief for taxpayers in an additional 5 percent. (In other cases, taxpayers generally are not entitled to relief.) These levels are consistent with historical norms. In addition, ongoing surveys conducted by an independent polling firm among taxpayers assisted by the TAS show that customer satisfaction stood at 84 percent in fiscal year 2004 and at 85 percent in fiscal year 2010.

Despite these positive results, the significant increase in case inventories is beginning to strain the TAS’s capacity. In fiscal year 2004, the TAS case advocates annually handled an average of 135 cases, and their caseloads have been steadily increasing since that time. In fiscal year 2010, the average annual case-

<sup>26</sup> IRC § 7803(c)(2)(D)(i)(I).

<sup>27</sup> From fiscal year 2004 to fiscal year 2010, levies rose from 2,029,613 to 3,606,818; liens rose from 534,392 to 1,096,376; and seizures rose from 440 to 605. See IRS FY 2010 Enforcement Results, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf).

<sup>28</sup> One important current project is the development and deployment of a new, fully integrated system for the TAS, which will automate many manual operations and integrate case advocacy, systemic advocacy, and all other TAS activities. This system, known as the Taxpayer Advocate Service Integrated System (TASIS), will replace more than 10 stand-alone systems and databases and improve efficiency by enabling employees to work across IRS systems, maintain and search case files electronically, and handle the intake, screening, and distribution of work electronically. The TASIS will also enable management to ensure a more even distribution of workload because it will provide information not merely on the number of cases per case advocate, but also on case complexity, required skills, and anticipated time required for case completion. Assuming the funding committed to the project is not cut or deferred, we anticipate that much of TASIS will be operational in 2013.

load per advocate rose to 240 cases, and in fiscal year 2011, it is projected to reach 249 cases.<sup>29</sup>

Because cases generally come to the TAS only when a taxpayer is suffering from a financial hardship or the IRS's regular processes have not worked as they should, the TAS as a practical matter is often a taxpayer's last resort. As the IRS's "safety net" for taxpayers, the TAS has had a policy of assisting all taxpayers who meet our case-acceptance criteria since the Congress created our organization in 1998. If the imbalance between our resources and the demand for our services widens much further, however, we will have no choice but to decline to accept certain categories of cases, leaving taxpayers to fend for themselves. I have served as the National Taxpayer Advocate for 10 years, and this is the first time I have felt compelled to sound this alarm. But I am deeply concerned that if the TAS is subject to spending freezes and does not have adequate resources, we will be forced to turn away cases and taxpayers will suffer significant hardships as a consequence.

*Low-income Taxpayer Clinics (LITCs).*—In 1998, the Congress established a grant program to fund LITCs.<sup>30</sup> LITCs primarily represent low-income taxpayers in Federal tax controversies with the IRS for free or for a nominal charge.<sup>31</sup> For fiscal year 2010, the Congress provided \$10 million for the LITCs.

Largely because of the recession and consequent job losses, LITC case inventories have risen substantially. LITCs collectively worked 16,374 cases in 2008 and 21,801 cases in 2009, an increase of 33 percent. During the first 6 months of 2010, LITCs worked 17,293 cases—more than the number they handled during all of 2008. Low-income taxpayers who face IRS audits or collection action have few alternative options for assistance. With roughly a doubling of cases in the last 2 years, it is critical that LITCs receive sufficient resources to deal with these caseloads.

In its fiscal year 2011 budget recommendation, the IRS Oversight Board recommended a \$2.3 million initiative to expand coverage of the LITC Program. The Oversight Board noted:

“The current economic environment presents significant challenges as the number of taxpayers who cannot pay their liabilities is increasing while available assistance from tax professionals is declining.

“Taxpayers who want to comply with their tax obligations and responsibilities must have access to information, assistance, and, when appropriate, representation. Low-income taxpayers who cannot afford representation can be at a disadvantage in resolving tax disputes with the IRS. For example, a recent TAS research study found that taxpayers who were represented in Earned Income Tax Credit (EITC) audits by attorneys, accountants, enrolled agents, or even unenrolled return preparers, were nearly twice as likely to receive the EITC, and received almost twice as much EITC, as taxpayers who were unrepresented. Thus, LITCs ensure that low-income taxpayers receive the correct outcome in controversies with the IRS and pay the correct tax amount.”<sup>32</sup>

The administration's proposed fiscal year 2012 budget would reduce funding for LITCs by \$500,000. I believe the LITCs need additional funding to provide assistance to low-income taxpayers whom the IRS has targeted for enforcement action.

### *Recommendations*

Both to improve tax compliance and to meet the needs of the taxpaying public, I recommend that the Congress provide additional funding for taxpayer-service activities, including increased funding for LITCs.

To enable the IRS to better meet the needs of small business taxpayers and tax-exempt organizations, I recommend that the Congress direct the IRS to conduct comprehensive TAB-like research studies of those populations.

<sup>29</sup> Average annual caseloads represent aggregate the TAS case receipts divided by the sum of case advocates, intake advocates, and half of TAS's lead case advocates. (lead case advocates spend approximately 50 percent of their time on non-case-specific work, including training and nonevaluative reviews).

<sup>30</sup> See IRC § 7526.

<sup>31</sup> Some LITCs provide tax education and outreach for taxpayers who speak English as a second language.

<sup>32</sup> IRS Oversight Board, *FY 2011 IRS Budget Recommendation* 23–24 (March 2010).



THE IRS BUDGET STRUCTURE DOES NOT ACCURATELY PORTRAY THE IRS'S ACTIVITIES  
AND PROBABLY OVERSTATES SPENDING FOR TAXPAYER SERVICE

As discussed above, the IRS since fiscal year 2006 has been proposing its budget by classifying most activities as either “taxpayer services” or “enforcement.” For a number of reasons, including the availability of program integrity allocation adjustments for enforcement initiatives (discussed below) and how the IRS approaches a program, the classification of an activity as taxpayer service or enforcement has consequences.

One threshold challenge in dividing the budget in this way is that there is no universal agreement on where to draw the line between service and enforcement. For the most part, I think people view “taxpayer service” as including IRS activities that assist them in voluntarily complying with their tax obligations. I think most people view enforcement as including activities the IRS undertakes to collect tax liabilities that have not been fully and timely paid.

The current budget follows what I view as a fairly arbitrary division of the IRS's activities into the taxpayer services and enforcement buckets. A few examples will illustrate:

*Processing Tax Returns.*—The budget treats the processing of tax returns entirely as a taxpayer service. In a response included in the National Taxpayer Advocate's 2010 Annual Report to Congress, the IRS wrote: “The millions of taxpayers who each year voluntarily file and pay their taxes likely would not view the processing of their refunds as anything other than a service activity.”<sup>33</sup> The thinking behind this statement is not self-evident. It is true, as the IRS has pointed out, that refunds are issued to many taxpayers in the course of returns processing, and it is understandable that taxpayers receiving a refund may see that activity as a service.

It is also true, however, that taxpayers filing returns with balances due are required to remit payment with their returns and that the IRS uses the information provided on all tax returns to help it determine which taxpayers to audit. As I observed only somewhat facetiously in my report, if collecting tax payments and facilitating audit selection are the types of services the IRS provides, I believe most taxpayers would choose to take a pass. In my view, returns processing is best classified as neither service nor enforcement. It is simply an overhead or support function that enables the IRS to collect taxes.

*AM.*—Funding for the AM Program, which includes the toll-free phone lines and correspondence processing, is included in the taxpayer services account, even though most of the AM budget is allocated toward working with taxpayers by phone or letter after the IRS has proposed a tax adjustment. If the IRS generates a notice telling a taxpayer he or she has under-reported income and owes additional tax, it is far from clear that the follow-up costs should be viewed as a “service” rather than “enforcement.”

*Field Assistance.*—Funding for the Field Assistance Program, which includes the IRS walk-in sites, is also included in the taxpayer services account. As with AM, more than half the work performed in the walk-in sites relates to account and notice work, so the decision to classify these activities as services is questionable.

*Small Business/Self-employed Operating Division.*—The Small Business/Self-Employed Operating Division (SB/SE) is tasked with serving all small businesses and self-employed taxpayers. For reasons I have described above, outreach and education are particularly important for this population. First-time business owners face a daunting array of employment tax requirements in addition to recordkeeping and other business income tax requirements. Growing businesses may not recognize tax issues that arise as they become more successful. Businesses experiencing financial difficulties may not understand that ignoring tax issues can further impair their economic viability in the short and long terms. Yet SB/SE is funded almost exclusively from the enforcement account. Only 1 percent of its funding comes from the taxpayer services account.<sup>34</sup>

*TAS and Appeals.*—Under the current budget structure, the TAS is funded entirely under the taxpayer services account, while the Office of Appeals is funded entirely under the enforcement account. I am discussing TAS and appeals together because they share similar characteristics. Neither function initiates contact with taxpayers. Rather, both functions become involved in a case

<sup>33</sup> National Taxpayer Advocate 2010 Annual Report to Congress 65–66 (Most Serious Problem: *The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding Its Ability to Serve Its Core Base of Individual Taxpayers Effectively*).

<sup>34</sup> IRS, Integrated Financial System, *Status of Available Funds Report* (FY 2010).

when a taxpayer is dissatisfied with actions another IRS function has taken and seeks us out for assistance. This similarity raises questions about the underlying rationale for the difference in budget classification.

There are other reasons to question the distinction as well. Most important, sound accounting principles generally require that revenues be matched with the expenses that generate them. If the IRS enforcement functions propose and collect additional tax amounts, downstream costs associated with the revenue the IRS receives arguably should be treated as part of the costs of enforcement. If the IRS treats revenue generated by the collection function as “enforcement” revenue, but apportions the costs of working with the affected taxpayers to the taxpayer services account—as it currently does by treating the TAS as a service expense—the net amount of IRS enforcement revenue will be overstated, perhaps considerably so. This will result in an inflated ROI on enforcement spending and has the potential to distort funding decisions.

In addition, the Office of Appeals is constantly seeking to reassure skeptical taxpayers and practitioners that, despite its placement within the IRS, it is independent from the IRS Examination and Collection functions and will provide taxpayers with an impartial hearing. The decision to fund Appeals entirely from the enforcement account along with the examination and collection functions may undermine Appeals’ effort to persuade outsiders that it is not simply another IRS enforcement function.

With respect to the foregoing examples, there is no objectively “correct” answer, so the existing budget categories are not necessarily wrong. But neither are they necessarily right, and that is the source of my concern. Using the terms “taxpayer services” and “enforcement” implies a bright-line distinction that cannot accurately be drawn. In that sense, the labels are arbitrary and somewhat misleading. In addition, because of the significant number of programs placed within the taxpayer services account that do not clearly belong there, I believe the budget may substantially overstate the amount of funding provided for programs that a layman would consider to be taxpayer services. This is significant as a matter of truth in packaging because it may paint an exaggerated portrait of how much emphasis the IRS places on taxpayer service activities. As discussed below, it is also significant because programs assigned to the enforcement account may have more funding flexibility due to the operation of program integrity allocation adjustments.

#### *Recommendations*

I recommend the following steps:

- Move the funding associated with returns processing into the operations support account.
- Divide the funding associated with AM and field assistance activities between the taxpayer services account and the enforcement account based on the underlying activities to which they relate.
- Divide funding for the TAS between the taxpayer services account and the enforcement account based on the percentage of the TAS cases that are service-related and the percentage of the TAS cases that are enforcement-related.
- Consider for the longer term devising a set of budget categories that do away with the artificial distinction between taxpayer service and enforcement.

THE “PROGRAM INTEGRITY ALLOCATION ADJUSTMENT” MECHANISM HAS BEEN USED IN A MANNER THAT ENABLES THE IRS TO RECEIVE EXTRA FUNDING FOR ITS ENFORCEMENT ACTIVITIES BUT NOT FOR ITS TAXPAYER SERVICE ACTIVITIES, DESPITE THE FACT THAT TAXPAYER SERVICE ACTIVITIES ALSO CONTRIBUTE TO COMPLIANCE

During the last few years, the IRS budget has utilized a mechanism that makes it relatively easy to provide increases for enforcement spending, but the procedure is not used for the taxpayer services account. Under this mechanism, known as a “program integrity allocation adjustment,” new funding appropriated for IRS enforcement programs generally does not count against otherwise applicable spending ceilings provided:

- the IRS’s existing enforcement base is fully funded; and
- a determination is made that the proposed additional expenditures will generate a ROI of greater than 1:1 (i.e., the additional expenditures will reduce the deficit on a net basis).

These conditions reflect the fact that the IRS is able to project the direct ROI of its enforcement activities—it can measure to the dollar the amounts collected by its examination, collection, and document-matching functions—but faces a much harder task in measuring the ROI of taxpayer services. As discussed above, it seems intuitively clear that the ROI of taxpayer service activities is greater than 1:1. Basic

services like publishing tax forms, providing guidance, and answering taxpayer questions are essential for enabling taxpayers to file returns and enabling the IRS to collect revenue. Yet because the IRS cannot quantify either the overall ROI of taxpayer service spending or the ROI of specific taxpayer service initiatives, taxpayer services spending is not currently considered eligible for program integrity allocation adjustments.

As a consequence, the IRS has been able to request larger increases each year for enforcement than for taxpayer services, and it is increasingly becoming more of an enforcement agency with a relatively smaller focus on taxpayer service. If the proposed fiscal year 2012 budget is adopted without change, as noted above, spending for the enforcement account will have increased by 15.4 percent while spending for the taxpayer services account will have declined by 0.3 percent since fiscal year 2006 on an inflation-adjusted basis.<sup>35</sup> In essence, the 15.4 percent increase in enforcement is entirely attributable to program integrity allocation adjustments. Under the proposed fiscal year 2012 budget, the IRS would receive an additional \$936 million in enforcement funding through this mechanism, which amounts to 16 percent of the \$5,966,619,000 enforcement total.

Moreover, the recent trend is likely to continue. The administration's fiscal year 2012 budget proposal contains spending projections for future years. Over the next 5 years (from fiscal year 2012 to fiscal year 2016), it projects that enforcement spending will rise by another 28 percent while taxpayer services spending will slightly decline.<sup>36</sup>

I am deeply concerned about the widening resource gap between the agency's taxpayer service and enforcement programs. First, for reasons discussed in the prior section, I think the distinction between service and enforcement can be highly artificial and arbitrary. To provide substantial additional funding to any program that gets classified as "enforcement" while reducing or holding flat spending for any program that gets classified as "taxpayer service" will not result in a balanced agency and may even encourage game-playing to classify priority programs as enforcement. Moreover, the classification of a program as "enforcement" rather than "service" has significant implications for the way the IRS treats taxpayers.

Second, as I have also discussed, it is widely acknowledged that taxpayer service contributes significantly to compliance. In some cases, service may contribute even more than enforcement to improved compliance. Because the IRS currently is unable to compute an ROI for service activities, however, service activities by themselves do not qualify for allocation adjustments.

Third, the Congress has given the IRS an increasing number of social and economic benefit programs to administer, and as I will discuss below, both of these types of benefits programs typically require more service.

The use of program integrity allocation adjustments has enabled the IRS to receive more funding than would otherwise be the case, and I think that is positive. But I strongly encourage the IRS and this subcommittee to consider ways to modify the way allocation adjustments are used so that taxpayer needs are met and the IRS remains a balanced agency. One possibility is to define new compliance initiatives more broadly, so that they include both an enforcement component and a service component. Because the projected ROI of some types of enforcement initiatives is high, a more broadly constructed initiative could still produce an ROI of greater than 1:1 (i.e., the service components would piggyback on the high-ROI enforcement activity). That could satisfy the requirements for an allocation adjustment while giving the agency more flexibility to meet taxpayer needs and improve compliance in obvious yet currently immeasurable ways.

#### *Example of a Broader Compliance Initiative*

Assume the IRS is planning a new enforcement initiative to improve compliance among small business taxpayers. The initiative will cost \$50 million and is projected to produce an ROI of 6:1 (or \$300 million in additional revenue). The IRS intends

<sup>35</sup> Compare Department of the Treasury, *FY 2012 Budget-in-Brief with Department of the Treasury, FY 2008 Budget-in-Brief*. (The FY 2006 budget was adopted using a different budget structure. The proposed FY 2008 budget shows the enacted FY 2006 totals as translated into the current budget structure.) Inflation adjustments were made using the Bureau of Labor Statistics inflation calculator, available at <http://data.bls.gov/cgi-bin/epicalc.pl>.

<sup>36</sup> Budget of the United States Government: Analytical Perspectives, Supplemental Materials Fiscal Year 2012: Federal Programs by Agency and Account, at 317–318, available at [http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/33\\_1.pdf](http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/33_1.pdf). Taxpayer service spending is shown on page 317 (see line labeled "Taxpayer Services: Appropriations, discretionary . . . 803"). Enforcement spending is the sum of the line on page 317 labeled "(Federal law enforcement activities): Appropriations, discretionary . . . 751" and the line on page 318 labeled "(Central fiscal operations): Appropriations, discretionary . . . 803."

to request \$50 million for this initiative as a program integrity allocation adjustment.

Assume further that the IRS has identified taxpayer service activities that would also improve small business compliance, such as new or additional types of outreach and education. The cost of the service initiative would be \$25 million, but the IRS cannot quantify the ROI.

If the IRS defines new compliance initiatives more broadly to include service activities, it could package the enforcement measures with the outreach and education measures and request \$75 million for the combined initiative as an allocation adjustment. The ROI would still be positive (the \$75 million cost and projected revenue of \$300 million would produce an ROI of 4:1). Most important, the IRS would be operating a more integrated, effective, and balanced compliance program.

#### *Recommendation*

I recommend that the IRS and the Congress consider ways to broaden the use of program integrity allocation adjustments so that compliance initiatives include taxpayer service components.

THE IRS DESPERATELY NEEDS TO CONDUCT OR COMMISSION BETTER RESEARCH SO IT CAN ALLOCATE ITS SERVICE AND ENFORCEMENT RESOURCES MORE EFFICIENTLY

The IRS would be able to allocate its resources more effectively if it had a better understanding of the causes of noncompliance and could test alternative compliance approaches. At present, the IRS has a tendency to treat all noncompliance as willful and to treat taxpayers who do not fully comply as “bad” taxpayers.

If all noncompliance reflected a willful decision by taxpayers to cheat the Government, a compliance approach that emphasizes hard-core enforcement measures might make sense. But much, if not most, noncompliance occurs for different reasons. In some cases, taxpayers do not know the rules. In some cases, taxpayers find complying with the rules excessively burdensome or confusing. In other instances, significant life events arise (e.g., illness, unemployment, or divorce) and taxpayers do not file returns. (This cuts both ways from a revenue standpoint. Some taxpayers who owe tax do not file returns, but many taxpayers who are due refunds each year also do not file returns and thus overpay their taxes.) In still other cases, taxpayers are too intimidated to file returns. For example, an individual who loses his job and cannot afford to pay may decide against filing a return because he fears what may happen if he reports a tax liability and cannot pay it.

In large part, the IRS’s one-size-fits-all approach reflects the absence of data on which to base better resource-allocation decisions. It bears emphasizing that “direct enforcement revenue” constitutes only about 2 percent of the revenue the IRS collects.<sup>37</sup> Ninety-eight percent of the revenue the IRS collects is paid voluntarily due to a combination of its taxpayer service programs and the indirect, deterrent effect of its enforcement activities. However, the IRS does not have adequate data to determine the relative contribution to compliance of taxpayer service and enforcement, let alone which components of taxpayer service and enforcement are most effective. Without these critical pieces of information, resource-allocation decisions are necessarily made more on the basis of best guesses and hunches than empirical evidence.

I suggest that the Congress consider directing the IRS to undertake additional research studies, perhaps utilizing the expertise of outside experts, to improve the accuracy of its ROI estimates for various categories of work, especially taxpayer service and the indirect effect of enforcement actions. The IRS should also improve its methods of verifying, retrospectively, the marginal ROI it has achieved for each category of work. ROI estimates should include costs relating to the downstream consequences of the various categories of IRS work, including increased phone calls and correspondence, Appeals conferences, TAS cases, and Tax Court litigation.

I acknowledge that developing reasonably accurate modeling is a significant challenge and will require a commitment of resources. Nonetheless, I have recommended in the past and continue to believe that this information will aid the IRS enormously in making resource-allocation decisions and will provide Members of Congress with additional information on which to base future funding decisions.<sup>38</sup>

<sup>37</sup>In fiscal year 2010, the IRS collected \$2.345 trillion. See IRS Data Book, FY 2010, Table 1. The amount of enforcement revenue it collected was \$57.6 billion. See IRS FY 2010 Enforcement Results, available at [http://www.irs.gov/pub/irs-utl/2010\\_enforcement\\_results.pdf](http://www.irs.gov/pub/irs-utl/2010_enforcement_results.pdf).

<sup>38</sup>The congressional budget rules currently prohibit the Congressional Budget Office or the Office of Management and Budget from treating changes in discretionary appropriations to the IRS as giving rise to scorable increases in tax receipts. See H.R. Conf. Rep. No. 101-964 (1990). See also Office of Management and Budget, *OMB Circular No. A-11*, Part 8, Appendix A, Prin-

*Recommendation*

I recommend that the Congress direct the IRS to undertake additional research studies, perhaps utilizing the expertise of outside experts, to improve the accuracy of its ROI estimates for various categories of work, especially taxpayer service and the indirect effect of enforcement actions.

THE IRS SHOULD REVISE ITS MISSION STATEMENT TO EXPLICITLY ACKNOWLEDGE THAT ITS TRADITIONAL ROLE AS THE TAX COLLECTOR HAS EXPANDED IN RECENT YEARS SO THAT IT IS NOW BOTH (I) COLLECTING TAXES AND (II) ADMINISTERING SOCIAL AND ECONOMIC BENEFIT PROGRAMS

Historically, the IRS's mission has been to collect taxes imposed by the Congress to fund Federal spending. In recent years, however, Congress has increasingly been using the tax code to provide economic incentives or social benefits for taxpayers.

In 1975, the Congress enacted the Earned Income Tax Credit, which allows low-income, working taxpayers to receive, through the tax code, Government payments that exceed their income tax liabilities. In 2008, the Congress directed the IRS to make Economic Stimulus Payments. Also beginning in 2008, the Congress made available the first of three iterations of the First-Time Homebuyer Credit. Beginning in 2009, the Congress provided the Making Work Pay Credit. Then last year, the Congress enacted the Hiring Incentives to Restore Employment Act, which provides incentives for small businesses to hire additional workers, and the Patient Protection and Affordable Care Act, which contains numerous provisions that will require interaction between the IRS and businesses or individuals.

In many cases, there are compelling reasons for administering these programs through the tax code. Absent adequate planning, however, I am concerned that directing a law enforcement agency to administer such programs could be problematic. While enforcement measures are required to prevent inappropriate claims in benefits programs, the overriding objective of agencies that administer benefits programs has traditionally been to help as many eligible persons qualify for the benefits as possible. That requires extensive outreach and even working one-on-one with potentially eligible individuals.

There are significant differences between benefits agencies and enforcement agencies in terms of culture, mind set, and the skill sets and training of their employees. Benefits agencies like the Social Security Administration and the Department of Veterans Affairs, despite some shortcomings, are primarily trying to get to yes—to help as many eligible persons qualify for benefits as possible. Enforcement agencies are more in the business of saying no. As the IRS prepares to administer large portions of the healthcare legislation, including approving claims by low-income persons for healthcare tax credits and imposing a penalty tax on those who are required to purchase health insurance but fail to do so, I believe the IRS should hire and train a new category of caseworkers—employees with social welfare-type backgrounds or similar training who will work one-on-one with taxpayers to resolve legitimate disagreements, instead of merely sending out notices saying, in effect, “you owe us.”

In addition, the IRS will require more funding to perform effectively both its traditional tax collection role and its expanding role as a benefits administrator. I am convinced that with adequate planning and funding, the IRS can do the job. But if the IRS does not recognize the importance of improving its benefits administration capacity or does not receive adequate funding, there are likely to be significant violations of taxpayer rights and significant taxpayer burden. In this regard, the trend toward increased funding for the IRS's enforcement account relative to the taxpayer services account, as discussed above, is concerning and should be carefully evaluated.

To help ensure that the IRS focuses on these challenges and that its needs are recognized in the budget process, I believe the IRS should revise its mission statement to make explicit that its mission is both to collect taxes and to deliver economic and social benefits authorized by the Congress. In this connection, the IRS should (i) revise Revenue Procedure 64-22 to include the IRS's responsibility as a benefits administrator; (ii) create a new program office and deputy commissioner position to provide strategic direction for all benefits programs; and (iii) conduct a comprehensive evaluation of the administration of previous and existing benefits programs to aid in the planning and implementation of future programs.

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principle 14 (2006). Because changes to IRS funding levels undoubtedly have an impact on tax collections, this prohibition seemingly reflects the practical difficulty of devising accurate estimates. Yet accurate estimates would be helpful to the Congress, and we believe the IRS should make developing better estimates a priority objective.

*Recommendation*

I recommend that the IRS revise its mission statement to make explicit that its mission is both to collect taxes and to deliver economic and social benefits authorized by the Congress.

## CONCLUSION

In this statement, I have attempted to describe six issues that this subcommittee may wish to consider. Some require immediate attention, while others would benefit from consideration over the longer term. In the near term, my overriding concern relates to the overall funding of the IRS. As the Nation's tax collector, the IRS is part of the solution to the problem of budget deficits, not part of the problem. There has been considerable discussion about freezing all domestic discretionary spending, which would presumably include funding for the IRS. I believe freezing or restricting IRS funding—either for taxpayer service activities or for enforcement activities—would be a mistake and would undermine the goal of closing the tax gap and reducing the deficit. I strongly encourage this subcommittee and the Congress to find a way to exempt the IRS from any such cuts.

PREPARED STATEMENT OF PAUL CHERECWICH, JR., CHAIRMAN, IRS OVERSIGHT BOARD, DEPARTMENT OF THE TREASURY

The Internal Revenue Service (IRS) Oversight Board thanks Chairman Durbin, Ranking Member Moran, and members of the subcommittee for the opportunity to present the Oversight Board's views on the administration's fiscal year 2012 IRS budget request.

This statement presents the Board's recommendations for the IRS' fiscal year 2012 budget and why the Board believes this level of funding is needed to meet the IRS needs. Created as part of the IRS Restructuring and Reform Act of 1998, the Oversight Board's responsibilities include overseeing the IRS in its administration, management, conduct, direction, and supervision of the execution and application of internal revenue laws. The Board is also responsible for ensuring that the IRS' organization and operations allow the agency to carry out its mission.

The Board has a responsibility to ensure that the IRS' budget and the related measured contained in the performance budget support the IRS Strategic Plan 2009–2013. In addition to this statement, the Board developed a special report in which it explains the detailed rationale for its budget recommendations. The report is available online at [www.irsoversightboard.treas.gov](http://www.irsoversightboard.treas.gov).

## FISCAL YEAR 2012 IRS BUDGET RECOMMENDATIONS SUMMARY

The IRS Oversight Board recommends a fiscal year 2012 IRS budget of \$13.342 billion, an increase of \$1.2 billion more than the fiscal year 2010 enacted IRS budget, and an increase of \$709 million more than the President's fiscal year 2011 IRS budget request.

The Board's fiscal year 2012 recommendation is substantially higher than those made in the IRS fiscal year 2010 and fiscal year 2011 budget recommendations due in part to the cost to implement provisions of the Patient Protection and Affordable Care Act (ACA), which totals \$473 million in the Board's fiscal year 2012 IRS budget recommendation. Tables 1 and 2 show more information on the Board's budget recommendations. Table 1 shows the program initiatives or increases the Board is recommending, and Table 2 shows the Board's recommendations budget by account. The Board has also included an appendix to this statement that summarizes new tax law provisions that have placed additional demands on IRS resources during the 2007–2010 filing seasons.

The Board's foremost priority within its fiscal year 2012 budget recommendation is the \$333.6 million in total funding recommended for the Business Systems Modernization (BSM) account, along with an associated \$52 million within the operations support account for information technology infrastructure to support ongoing BSM maintenance.

The Board's second-highest priority is funding of taxpayer service that allows for the restoration of an 80 percent level of service (LOS) on IRS toll-free telephone assistance during fiscal year 2012. The Board believes that additional funding is needed to improve toll-free service, as major changes to the tax laws in recent years have contributed to a substantial increase in the number of calls to the IRS and a corresponding drop in the LOS. The Board notes that it foresees a greater demand for toll-free assistance in the coming years, driven by a proliferation of new tax provisions.

TABLE 1.—IRS OVERSIGHT BOARD RECOMMENDED FISCAL YEAR 2012 IRS BUDGET

	Amount
Fiscal year 2010 enacted budget .....	\$12,146,123
Fiscal year 2011 annualized continuing resolution Level .....	\$12,146,123
Maintaining current levels .....	\$85,754
Efficiencies/savings .....	(\$189,957)
Base reinvestment: consolidate submission processing Atlanta .....	\$1,486
Adjustment fiscal year 2011 President's policy level .....	\$401,665
Fiscal year 2012 adjusted base .....	\$12,445,071
Improve taxpayer service .....	\$81,307
IRS.gov improvements .....	\$33,000
Taxpayer service initiatives .....	\$114,307
Increase international service and enforcement .....	\$72,596
Increase collection coverage .....	\$52,000
Implement merchant card and basis reporting .....	\$35,730
Increase coverage to address tax law changes and other compliance issues .....	\$96,718
Ensure accurate delivery of tax credits .....	\$260,293
Administer new statutory reporting requirements .....	\$58,505
Leverage return preparer .....	\$16,600
Address appeals workload growth .....	\$9,100
Implement uncertain tax position (UTP) reporting requirements .....	\$4,129
Enforcement initiatives .....	\$605,671
Enhance security and disaster recovery .....	\$35,000
Update integrated financial system .....	\$27,500
Leveraging data to improve compliance .....	\$1,400
Enhance physical security for employees .....	\$31,057
Implement individual coverage requirement and employer responsibility payments .....	\$62,477
Attract, retain, and develop a quality workforce .....	\$20,000
Infrastructure initiatives .....	\$177,434
BSM initiative: continue migration from aging tax administration system .....	.....
Continue migration from aging tax administration system .....	.....
Health Insurance Tax Credit Administration .....	.....
Total Oversight Board budget .....	\$13,342,483
President's fiscal year 2012 budget .....	\$13,283,907
Increase over President's budget .....	\$58,576
Percentage increase over President's budget .....	0.4

TABLE 2.—IRS OVERSIGHT BOARD RECOMMENDED FISCAL YEAR 2012 BUDGET BY ACCOUNT

	Taxpayer service	Enforcement	Operations support	BSM	Health Insurance Tax Credit Administration	Total
Fiscal year 2010 enacted budget .....	\$2,278,830	\$5,504,000	\$4,083,884	\$263,897	\$15,512	\$12,146,123
Fiscal year 2011 annualized continuing resolution level .....	\$2,278,830	\$5,504,000	\$4,083,884	\$263,897	\$15,512	\$12,146,123
Maintaining current levels .....	\$12,908	\$30,691	\$41,755	\$168	\$232	\$85,754
Efficiencies/savings .....	(\$41,333)	(\$21,996)	(\$124,440)	(\$1,026)	(\$1,162)	(\$189,957)
Base reinvestment: consolidate submission processing Atlanta .....	\$1,486					\$1,486
Adjustment fiscal year 2011 President's policy level .....	\$23,254	\$242,275	\$10,128	\$122,561	\$3,447	\$401,665
Taxpayer service initiatives .....	\$44,078		\$70,229			\$114,307
Improve taxpayer service .....	\$44,078		\$37,229			\$81,307
IRS.gov improvements .....			\$33,000			\$33,000
Enforcement initiatives .....	\$25,910	\$209,668	\$370,093			\$605,671
Increase international service and enforcement .....		\$48,363	\$24,233			\$72,596
Increase collection coverage .....	\$2,201	\$30,275	\$19,524			\$52,000
Implement merchant card and basis reporting .....	\$10,475	\$17,495	\$7,760			\$35,730
Increase coverage to address tax law changes and other compliance issues .....	\$7,229	\$33,936	\$55,553			\$96,718
Ensure accurate delivery of tax credits .....	\$4,946	\$49,083	\$206,264			\$260,293
Administer new statutory reporting requirements .....	\$1,059	\$5,061	\$52,385			\$58,505
Leverage return preparer .....		\$14,240	\$2,360			\$16,600
Address appeals workload growth .....	\$7,450	\$1,650	\$9,100			\$16,600
Implement UTP reporting requirements .....		\$3,765	\$364			\$4,129
Infrastructure initiatives .....	\$500	\$7,911	\$169,023			\$177,434
Enhance security and disaster recovery .....			\$35,000			\$35,000
Update integrated financial system .....			\$27,500			\$27,500
Leveraging data to improve compliance .....			\$1,400			\$1,400
Enhance physical security for employees .....		\$3,911	\$27,146			\$31,057
Implement individual coverage requirement and employer responsibility payments .....			\$62,477			\$62,477



Attract, retain, and develop a quality workforce .....	\$500	\$4,000	\$15,500			\$20,000
BSM initiative: continue migration from aging tax administration system .....			\$52,000	(\$52,000)		
HITCA .....						
Total .....	\$2,345,633	\$5,972,549	\$4,672,672	\$333,600	\$18,029	\$13,342,483

Appendix 1, taken from the Board's Annual Report to Congress 2010, provides a summary of major legislative and administrative tax provisions enacted in recent years and the challenges that each presented to tax administration during the 2007 through 2010 filing seasons. In addition to describing the impacts associated with implementing these provisions, the appendix provides a short assessment of the IRS' performance in implementing many of them made by either the Government Accountability Office (GAO) or the Treasury Inspector General for Tax Administration (TIGTA).

The appendix highlights the many challenges the IRS faced in implementing new tax provisions that affected the last four filing seasons. Expanding taxpayer service and enforcement programs to ensure these provisions were understood and being claimed properly by taxpayers put a significant demand on IRS resources.

The Board's IRS budget recommendation also acknowledges the wide range of new responsibilities under the ACA, such as the administration of new tax credits and additional information reporting.

#### *Resources Needed To Implement the ACA*

The detail in Table 3 makes the fiscal year 2012 budget needs for implementing the ACA fully transparent. The IRS has been tasked with a wide range of new responsibilities under the ACA, including the requirements that it:

- Administer new tax credits for individuals and businesses;
- Collect a new excise tax on tanning services and a new fee on certain businesses engaged in the manufacturing and importing of prescription drugs;
- Implement expanded exemption requirements on charitable hospitals; and
- Gather, process, and share additional information reports.<sup>1</sup>

The Board concurs with the President's budget request as to what the IRS funding needs are in fiscal year 2012 to responsibly implement the ACA as currently enacted. As shown in Table 3, the fiscal year 2012 funding needed to implement the ACA is \$473 million with a staffing level of 1,269 full-time equivalents (FTEs). The Board's budget recommendation identifies the funds the IRS needs to provide the necessary assistance, enforcement presence, and supporting systems infrastructure to carry out the ACA requirements in an effective manner.

Of the total dollar funding needed in fiscal year 2012 for the ACA, nearly 83 percent is in the operations support account, much of which is for IRS staff, contractors, hardware, and software needed to build new IT systems and to modify existing tax processing systems to accommodate the new ACA provisions.

#### OVERSIGHT BOARD'S BUDGET PRIORITIES

The Board's budget recommendation for fiscal year 2012 is approximately \$59 million higher than the President's request of \$13.284 billion, a difference of 0.4 percent. The Board firmly believes that its fiscal year 2012 IRS budget recommendation is the minimum imperative for strong and responsible tax administration. The Board's recommendation calls for an overall IRS appropriation in fiscal year 2012 of \$2.35 billion for the taxpayer service account; \$5.97 billion for the Enforcement account; \$4.67 billion for the operations support account; \$333.6 million for the BSM account; and \$18 million for the Health Insurance Tax Credit Administration (HITCA) account.

In the view of the Board, its budget recommendation reflects a proper balance between taxpayer service and tax law enforcement, funds strategic investments to reduce the tax gap and replace antiquated IRS tax processing systems, and furthers other strategic objectives of tax administration such as greater leveraging of Internet capabilities.

<sup>1</sup>Enactment of Public Law 112-9 on April 14, 2011 repeals certain information reporting required by the ACA and reduces the funding needed for ACA implementation by \$23.3 million and lowers the entire request by that amount.

TABLE 3.—ACA-RELATED FUNDING AND FTE BY INITIATIVE  
 [Dollars in thousands]

	Taxpayer service		Enforcement		Operations support		Total	
	Amount	FTE	Amount	FTE	Amount	FTE	Amount	FTE
<b>Taxpayer service initiatives:</b>								
Improve taxpayer service .....	\$20,725	150	\$30,582	51,307	\$150			
Subtotal, taxpayer service initiatives .....	\$20,725	150	\$30,582	51,307	\$150			
<b>Enforcement initiatives:</b>								
Increase coverage to address tax law changes and other compliance issues .....	\$4,904	46	\$22,784	174	\$45,927	143	\$73,615	363
Ensure accurate delivery of tax credits .....	\$4,946	49	\$23,015	233	\$199,535	222	\$227,496	504
Administer new statutory reporting requirements .....	\$1,059	7	\$5,061	48	\$52,385	132	\$58,505	187
Subtotal, Enforcement initiatives .....	\$10,909	102	\$50,860	455	\$297,847	497	\$359,616	1,054
<b>Infrastructure initiatives:</b>								
Implement individual coverage requirement and employer responsibility payments .....					\$62,477	65	\$62,477	65
Subtotal, Infrastructure initiatives .....					\$62,477	65	\$62,477	65
<b>Total, fiscal year 2012 ACA initiatives .....</b>	<b>\$31,634</b>	<b>252</b>	<b>\$50,860</b>	<b>455</b>	<b>\$390,906</b>	<b>562</b>	<b>\$473,400</b>	<b>1,269</b>

Moreover, the Board's foremost priority within its fiscal year 2012 budget recommendation is the \$333.6 million in total funding recommended for the BSM account, along with an associated \$52 million within the operations support account for information technology infrastructure to support the ongoing maintenance of BSM components that have been successfully implemented. This level of funding for BSM is imperative and requires a \$122.6 million increase in fiscal year 2011 in the base BSM account to achieve the President's policy level—a proposed adjustment contained in both the Board's recommendation and the President's budget request.

The Board assigns top budget priority to BSM funding primarily because of the critical role these resources will play in modernizing the core taxpayer account system for individual taxpayers under the Customer Account Data Engine 2 (CADE 2) Program. With the recommended funding, the CADE 2 Program is poised to deliver daily account processing by the 2012 filing season, a major milestone in the IRS BSM effort that will yield tangible benefits, such as quicker refunds, to tens of millions of taxpayers. The Board's recommended investments in BSM also lay the necessary technological foundation for other major advancements in IRS efficiency, taxpayer service, and enforcement for years to come—thereby helping to achieve the strategic goals of the agency. Both the TIGTA and the GAO agree that modernizing the IRS' antiquated computer systems, for which CADE 2 is instrumental, is critical to providing improved and expanded service to taxpayers.

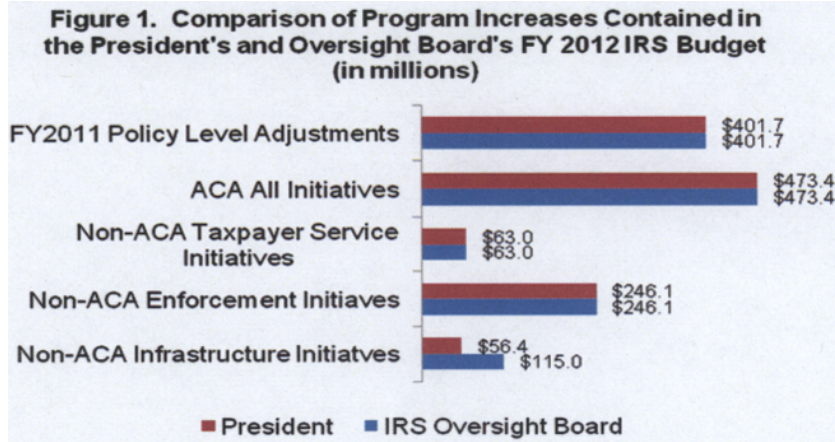
The Board's second-highest priority is funding of taxpayer service that allows for the restoration of an 80 percent LOS on IRS toll-free telephone lines during fiscal year 2012. Achieving this LOS requires both the \$23.3 million increase in fiscal year 2011 to reach the President's policy level and the \$81.3 million initiative in fiscal year 2012 to improve taxpayer service. Recent experience shows that tens of millions of taxpayers still depend on the IRS toll-free telephone operations for assistance in understanding their tax obligations, their eligibility for various tax credits and other tax provisions, or to resolve their account balances. However, major changes to the tax laws in recent years have contributed to a substantial increase in the number of calls to the IRS and a corresponding drop in the LOS into the low 70 percent range. In addition, as more of the provisions of the ACA become effective in 2012, the Board believes that demand for IRS toll-free assistance will grow. Thus, the Board sees it as imperative that the IRS provides taxpayers with an adequate level of telephone assistance in the coming fiscal year; a level the Board believes should be no less than 80 percent. Increased telephone demand, driven by a proliferation of new tax provisions, has prevented the IRS from reaching this level, last achieved in 2007, and the Board believes taxpayers deserve no less in such a complex tax environment.

The IRS has also been tasked with a wide range of new responsibilities under the ACA, such as the administration of new tax credits for individuals and businesses, and additional information reporting. These new responsibilities must be afforded budget priority as well to enable the IRS to properly implement the law. Both the Board's recommendation and the President's budget make transparent the resources in fiscal year 2012 needed to implement the ACA. These ACA funding requirements total \$473 million with a staffing level of 1,269 FTEs. Of the total dollar funding recommended, nearly 83 percent is in the operations support account—much of it for IRS staff, contractors, hardware, and software needed to build new IT systems and to modify existing tax processing systems to accommodate the new ACA provisions.

#### COMPARISON OF OVERSIGHT BOARD'S AND PRESIDENT'S BUDGET RECOMMENDATIONS

The Board's budget recommendations are largely consistent with the President's budget request in many categories. In particular, inflation adjustments, savings, and reinvestments are identical in both budgets. To facilitate a direct comparison of the Board's recommendations to the President's budget, the Board's budget mirrors the upward adjustments to the fiscal year 2011 base funding to reach the President's policy level. However, it is important to note that these adjustments to achieve the President's policy levels essentially reflect proposed increases to the base IRS budget in fiscal year 2011; increases which had not been enacted at the time the Board and the President prepared their fiscal year 2012 IRS budget recommendations, and which may or may not be realized.

As shown in Figure 1, for its first and second funding priorities, BSM and taxpayer service, the Board recommended budget and the President's budget request are the same. The proposed enforcement budgets, as well as the ACA-related funding, are also the same in both budgets, as is the Health Insurance Tax Credit Administration.



The \$58.6 million difference between the Board's fiscal year 2012 IRS funding recommendation and the President's budget request occurs in three areas. The Board believes that more resources are needed in the area of IRS security and applauds the President's budget request for including two valuable initiatives in these areas: (1) to improve IRS system security and disaster recovery capabilities and (2) another to improve physical security at IRS facilities. The Board notes that TIGTA has identified security as the top management challenge facing the IRS. The Board recommends higher funding levels in both areas. The Board is also recommending an additional initiative not contained in the President's request, which accounts for the third area of difference.

Specifically, the Oversight Board recommends that:

- an additional \$23 million be added to the infrastructure initiative in the President's budget to enhance security and disaster recovery systems capability;
- an additional \$15.6 million be added to the infrastructure initiative in the President's budget to enhance physical security for Federal employees; and
- an additional infrastructure initiative be approved for \$20 million to attract, retain, and develop a highly engaged workforce.

All the budget recommendations by the Oversight Board are driven by the need to support the IRS Strategic Plan 2009–2013. As the Oversight Board has emphasized in its 2009 annual report to the Congress, the IRS has a strategic plan that addresses two serious weaknesses of the tax administration system: the tax gap and the IRS' archaic information technology systems. The need to overcome these weaknesses, as well as effectively implementing the new tax-related provisions of the ACA drives the Board's IRS budget recommendations.

**GOAL 1: IMPROVE SERVICE TO MAKE VOLUNTARY COMPLIANCE EASIER**

The President's policy level adjustment and the two taxpayer service initiatives contained in the President's budget request and listed in Table 4. The Board considers its support of the \$23.3 million fiscal year 2011 policy level adjustment for taxpayer service and the \$81.3 million fiscal year 2012 initiative to improve taxpayer service particularly important to America's taxpayers, and has identified them as its second-highest funding priority.

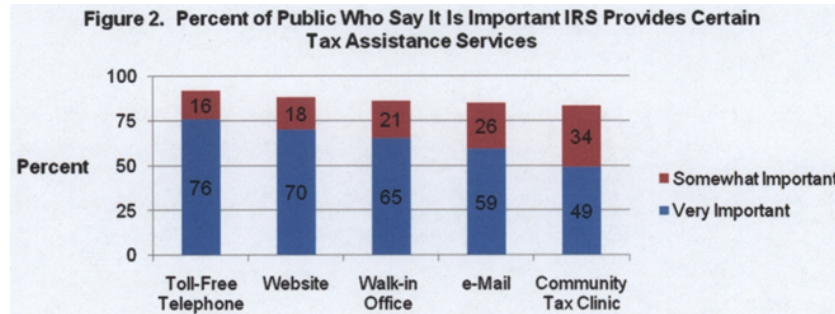
**TABLE 4.—TAXPAYER SERVICE ADJUSTMENT AND INITIATIVES RECOMMENDED BY THE OVERSIGHT BOARD AND THE PRESIDENT**  
[In thousands of dollars]

	Amount	Portion due to the ACA implementation
President's policy level adjustment .....	23,254	.....
Taxpayer service initiatives:		
Improve taxpayer service .....	81,307	51,307

TABLE 4.—TAXPAYER SERVICE ADJUSTMENT AND INITIATIVES RECOMMENDED BY THE OVERSIGHT BOARD AND THE PRESIDENT—Continued  
 [In thousands of dollars]

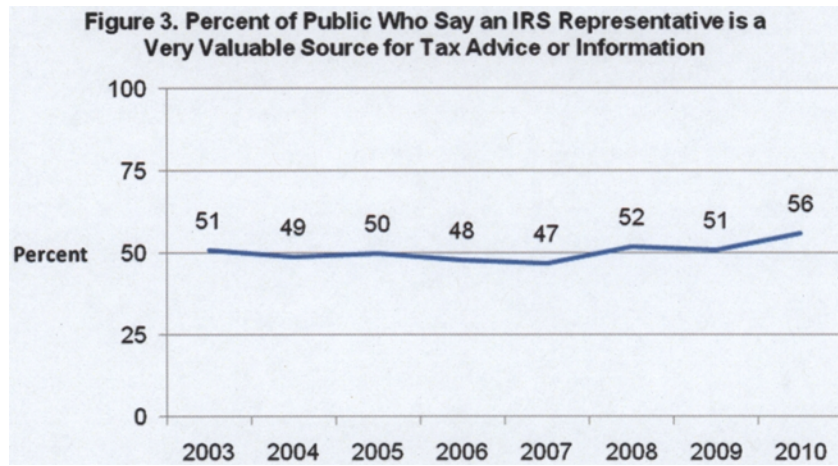
	Amount	Portion due to the ACA implementation
IRS.gov Improvements .....	33,000	.....
Initiative total .....	114,307	51,307

Data from the IRS Oversight Board 2010 taxpayer attitude survey attests to the value taxpayers place on the IRS taxpayer assistance programs and the IRS toll-free telephone assistance operation in particular. As shown in Figure 2, more than 80 percent of the public say it is either very or somewhat important that the IRS provide assistance on certain key service channels including assistance via toll-free telephone lines, an IRS Web site, and IRS office locations for walk-in assistance. In most instances, a sizable majority say it is “very important.”



SOURCE.—IRS Oversight Board 2010 Taxpayer Attitude Survey.

The Board’s survey further shows an increase in recent years in the percentage of the public who say that an IRS representative is a “very valuable” source for tax advice. As depicted in Figure 3, that upward trend, beginning in 2008, coincides with the start of major tax law changes designed to spur the economy. Clearly, taxpayers see a growing importance for the assistance the IRS provides through its service programs.

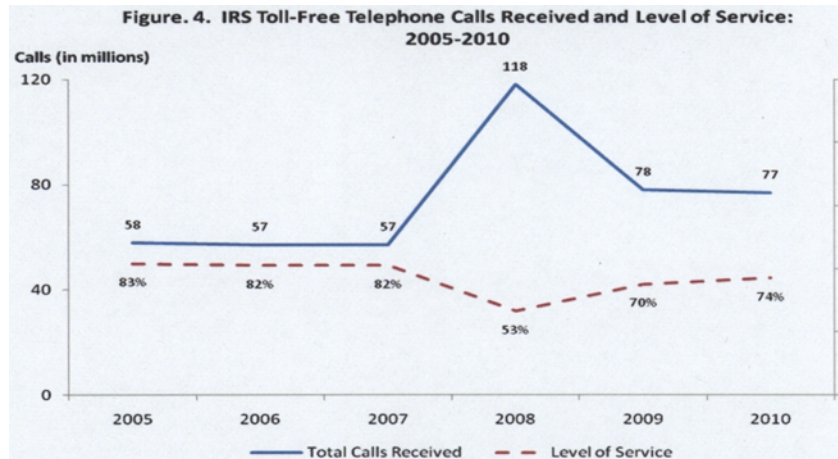


SOURCE.—IRS Oversight Board Taxpayer Attitude Survey.

The Board believes that quality IRS assistance is critical to maintaining and ultimately improving voluntary compliance. Both the fiscal year 2011 adjustment to achieve the President's policy level and the fiscal year 2012 initiative to improve taxpayer service are needed to provide an 80 percent level of service in fiscal year 2012 on the IRS toll-free telephone operations, while maintaining an answer accuracy rate above 92 percent. In the view of the Board, the IRS should be equipped with the resources to deliver no less than an 80 percent telephone level of service. However, the IRS has fallen short of that standard in recent years. Should the Congress and the President agree on an IRS funding level for the rest of fiscal year 2011 that does not include the policy level adjustment, an additional \$23.3 million will need to be added to the fiscal year 2012 initiative to improve taxpayer service.

As indicated in Figure 4, during the 3-year period prior to 2008, the IRS was receiving just under 60 million calls per year on its toll-free assistance lines and delivering a LOS of just more than 80 percent. However, due primarily to major tax law changes, such as those relating to economic stimulus payments, recovery rebate credits, and several other special tax provisions, the number of calls the IRS received rose sharply starting in 2008 and is now nearly 80 million calls per year. This increase in call volume has resulted in a corresponding drop in LOS, which now stands in the low 70 percent range. In looking forward to 2012, the Board seeks to ensure that taxpayers once again receive a minimum 80 percent level of service, addressing not only the slippage that has occurred since 2008, but also the increased call volume that will surely ensue as provisions of the ACA become effective.

The Board also views as an important investment the Expand Online Options Through IRS.gov Improvements initiative to upgrade and expand IRS Internet services. The resources recommended for the IRS.gov Web site reflect a strategic investment that is key to providing substantially better service to greater and greater numbers of taxpayers in the years to come. This initiative furthers one of the guiding principles articulated in the IRS Taxpayer Assistance Blueprint, which calls for the IRS to enhance its Web site so that it becomes the first choice of more taxpayers for obtaining the information and services needed to comply with tax obligations. It also advances one of the core objectives in the IRS Strategic Plan 2009–2013 to deploy advanced information technology tools to improve IRS efficiency and productivity, and to expand online services that improve service and enforcement. In 2010, the IRS recorded more than 304 million page visits on IRS.gov, up from around 268 million visits in 2009, and roughly double the volume experienced in 2004.



SOURCE.—IRS and GAO.

There is little doubt that IRS Internet applications for both internal and external customers are foundational to the success of tax administration. However, the IRS needs to replace its aging and outdated Internet portal environment to improve security and the quality of its Web services. The critical upgrades and expansion of the IRS Web site funded by this initiative are key to achieving the long-term vision for electronic tax administration inspired by the IRS Restructuring and Reform Act of 1998; a vision in which the vast majority of taxpayer interaction with the tax administration system are handled electronically. Moreover, taxpayer services deliv-

ered over the Internet are considerably less expensive than telephone service. Also, investing in an improved Internet capability that eventually lessens telephone volume will result in future savings. In addition, because the Internet is available to taxpayers 24 hours a day, it overcomes a limitation of IRS telephone service.

GOAL 2: ENFORCE THE LAW TO ENSURE EVERYONE MEETS THEIR OBLIGATION TO PAY  
TAXES

The IRS Oversight Board supports the fiscal year 2011 adjustment and nine enforcement initiatives that are contained in the President's budget and listed in Table 5.

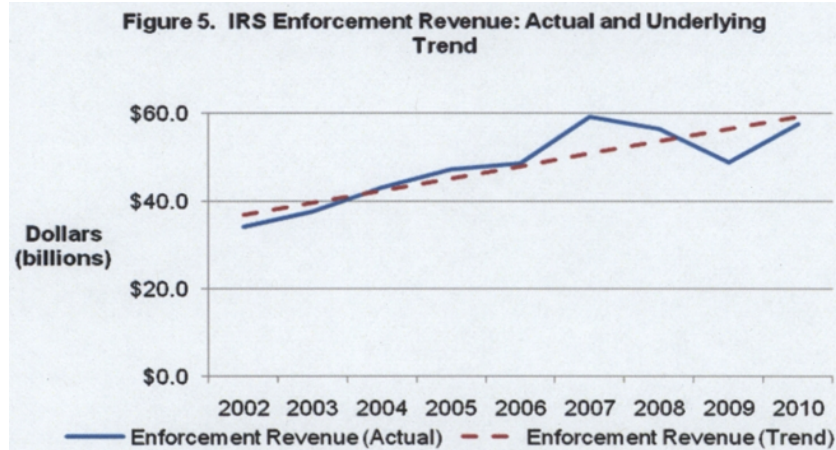
The Oversight Board supports the President's proposed increases in the enforcement area in part because they continue a funding pattern in more recent years that has enabled the realistic and steady growth in enforcement resources; a pattern the Board has consistently recommended. For example, the IRS reports that staffing for its key enforcement occupations of Revenue Officers, Revenue Agents, and Special Agents, has grown from 20,113 in fiscal year 2002, to 21,185 in fiscal year 2006, to 22,710 in fiscal year 2010.

TABLE 5.—ENFORCEMENT ADJUSTMENT AND INITIATIVES RECOMMENDED BY THE OVERSIGHT  
BOARD AND THE PRESIDENT  
[In thousands of dollars]

	Amount	Portion due to the ACA implementation
President's policy level adjustment .....	242,275	.....
Initiatives:		
Increase international service and enforcement .....	72,596	.....
Increase collection coverage .....	52,000	.....
Implement merchant card and basis reporting .....	35,730	.....
Increase coverage to address tax law changes and other compliance issues .....	96,718	73,615
Ensure accurate delivery of tax credits .....	260,293	227,496
Administer new statutory reporting requirements .....	58,505	58,505
Leverage return preparer .....	16,600	.....
Address appeals workload growth .....	9,100	.....
Implement UTP reporting requirements .....	4,129	.....
Initiative total .....	605,671	359,616

The gradual growth in enforcement resources has allowed the IRS to increase its enforcement presence among both business and individual taxpayers, and is generally reflected in the IRS enforcement revenue results, which totaled \$57.6 billion in fiscal year 2010. The value of IRS enforcement programs is more than just direct revenue, and year-to-year fluctuations in IRS enforcement revenue occur for various reasons, such as the final resolution of large dollar cases worked over several years. Nevertheless, the clear upward trend in direct enforcement revenue attributed to IRS compliance programs since 2002, as shown in Figure 5, illustrates one tangible result from funding a greater IRS enforcement presence in more recent years.





In the view of the Board, the recommended fiscal year 2011 policy adjustment and fiscal year 2012 initiatives also bolster IRS enforcement operations in a manner consistent with the IRS strategy to reduce the tax gap. In particular, the Board's and the President's recommended funding for enforcement initiatives combines a focus on:

- expanded IRS global enforcement presence relative to business and individual taxpayers with international economic activity;
- efforts to improve the accuracy of return submissions provided through paid tax preparers;
- implementation and leveraging of various new information reporting requirements;
- improved technology tools and increased enforcement staffing to detect fraud and other noncompliance with a myriad of new and existing tax credits, several involving rather substantial amounts; and
- with attention to workload growth in appeals to ensure taxpayer rights are protected.

The Board also notes that more than 40 percent of the total requested amounts for the fiscal year 2011 policy level adjustment and these fiscal year 2012 initiatives are directed toward the implementation of the ACA—most of which are for the investment in new technology and related infrastructure to administer the new tax credits. Among these new credits are those for small businesses to help them provide healthcare coverage for their employees and the new premium credit designed to help millions of other Americans purchase individual health coverage. The Board strongly believes that a balanced approach to the implementation of the ACA requires a proper degree of compliance activity, in addition to taxpayer assistance efforts, to deter noncompliance and fraud.

The Board further notes that while IRS enforcement efforts produce direct revenue, their indirect contributions to voluntary compliance are likely even greater. IRS enforcement presence helps improve voluntary compliance by discouraging non-compliance by those who might otherwise be tempted to under-report their taxes and by giving compliant taxpayers confidence in the tax system and the fairness with which the IRS is administering the tax laws.

To provide further context to the value of improved voluntary compliance, the Board notes that a 1 percentage point improvement in the voluntary compliance rate translates into an additional \$21 billion per year in timely paid Federal taxes, based on estimates for tax year 2001 developed from the IRS National Research Program. Some signs of potentially improved voluntary compliance from IRS enforcement efforts can be found in the Board's 2010 taxpayer attitude survey. Respondents who had received an IRS-initiated contact in the prior year, such as a math error notice, were less likely to agree that it is acceptable to cheat on one's taxes (either "a little here and there" or "as much as possible") than were respondents who had not been contacted by the IRS, i.e., 8 percent of the former versus 12 percent for the latter.

STRATEGIC FOUNDATIONS: INVEST FOR HIGH PERFORMANCE IN PEOPLE AND  
TECHNOLOGY

Strategic foundations comprise two accounts in the IRS budget: BSM and operations support.

**BSM**

The IRS Oversight Board supports the total fiscal year 2012 budget of \$333.6 million for the BSM account as contained in the President's budget request and summarized in Table 6. The Board considers its funding recommendation for BSM as its highest priority because it reflects a strategic investment, which is crucial to rectifying one of the fundamental weaknesses in the current tax administration environment, i.e., archaic IRS tax processing systems.

Embedded in the President's request and the Board's recommendation for BSM is an fiscal year 2011 adjustment (increase) of \$122.6 million to achieve the President's policy level. Because the Board considers BSM funding its highest priority, it further emphasizes that if the IRS does not receive the \$122.6 million increase in fiscal year 2011 to achieve the President's policy level, then this amount should be viewed as a Board-recommended fiscal year 2012 initiative for BSM.

TABLE 6.—TOTAL PROPOSED FISCAL YEAR 2012 BUDGET FOR BSM BY PROJECT ACTIVITY  
RECOMMENDED BY THE OVERSIGHT BOARD AND THE PRESIDENT

[In thousands of dollars]

BSM projects/initiatives	Fiscal year 2012 budget
Application migration to CADE 2 (taxpayer account database) .....	156,800
Current CADE .....	19,000
Modernized e-File .....	20,500
Core infrastructure .....	37,700
Architecture, integration, and management .....	27,645
Management reserve .....	2,622
Subtotal, capital investment .....	264,267
BSM labor .....	69,333
Total, BSM .....	333,600

The President's request and the Board's recommendations for BSM also include a proposed shift in fiscal year 2012 of \$52 million (following the President's requested policy level increase for BSM in fiscal year 2011) from the BSM account to the operations support account. This shift recognizes that as major components of IRS' aging computer technology are modernized through successful BSM efforts, the ongoing operation and maintenance needs of these components can best be met in the future as part of the funding for existing IT infrastructure within the operations support account.

The information in Table 6 reflects the BSM budget for fiscal year 2012 by project activity, assuming the Board's recommendations and President's request for BSM are enacted. Most of the total BSM budget, including nearly 60 percent of the portion devoted to capital investments, reflect the funds needed for the CADE 2 Program. By the 2012 filing season, CADE 2 will provide a modern relational database and daily updating capability for the core tax processing system for individual accounts. The IRS refers to this important milestone as "Transition State 1."

Achievement of Transition State 1 under the CADE 2 Program will have immediate benefits to taxpayers, including more timely account balance information to better serve taxpayers and the issuance of quicker refunds to the roughly 109 million individual refund filers each year—a major leap forward from the much smaller pool of about 41 million taxpayers receiving daily account processing today under the more limited "current" CADE system. The CADE 2 funding also enables the IRS to build on its new relational database foundation and begin the work on Transition State 2, which will help address long-standing financial material weaknesses identified by the GAO, and begin the replacement of current service and enforcement applications, based on antiquated computer code, with state-of-the-art, Internet-centric modular applications using modern programming languages.

The annual assessment of the BSM Program by TIGTA lends further support to the merits of the requested BSM funds for CADE 2. As TIGTA stated in their assessment issued in September 2010,

“The IRS has refocused the BSM Program to deliver the modernized systems sooner. TIGTA is encouraged by the actions planned and taken to refocus the BSM Program, especially related to the retooling of the CADE Program, known as CADE 2. When successful, the CADE 2 Program will provide a significant boost to the IRS’ ability to move away from its antiquated tax return processing systems and provide improved service to taxpayers.”<sup>2</sup>

The Board’s recommended funding for BSM will help the IRS advance technologically on other fronts as well, such as enabling the IRS to continue further expansion of its successful Modernized e-File (MeF) applications to include the employment series tax returns such as the Form 941, Employer’s Quarterly Federal Tax Return. Extending MeF capabilities to employment tax returns is particularly strategic, for as was emphasized in the Board’s recent 2010 report to the Congress on electronic filing, achieving the IRS long-term goal of an 80 percent e-file rate for all major tax returns will require effective strategies to substantially increase the volume of electronically filed employment tax returns, particularly the Form 941.

The modern relational database to be achieved through the CADE 2 Program and the Internet-filing capabilities achieved through the expanding universe of MeF systems, provide the necessary foundations for a new generation of tools and Internet applications that can dramatically improve IRS service and enforcement programs. That is why it so important, in the view of the Board, that policymakers provide the needed BSM funding requested by the President. Indeed, in designating the IRS BSM Program as one of the Government programs on its “High-Risk Series” list, the GAO has emphasized that the development and delivery of the modernized tax administration and internal management systems are

“. . . critical to providing improved and expanded service to taxpayers and internal business efficiencies for IRS and providing reliable and timely financial management information needed to better enable IRS to justify its resource allocation decisions and congressional budgetary requests.”<sup>3</sup>

*Operations Support*

The IRS Oversight Board supports the fiscal year 2011 adjustment in the operations support account and the six infrastructure initiatives contained in the President’s budget request, but also believes more funding is needed. In particular, the infrastructure funding requested by the President and supported by the Board is vital to sensible tax administration including resources needed to improve security for IRS systems and staff; provide for a long-overdue upgrade to the IRS’ obsolete financial management system that currently prevents the agency from meeting Federal accounting standards; and enable the development of the technology and other infrastructure components to implement major provisions of the ACA including new information reporting requirements.

However, while the Board applauds the President’s budget request for including initiatives to enhance IRS computer systems security and disaster recovery capabilities, and to enhance physical security at IRS facilities, the Board believes more resources are warranted. In addition, the Board is also proposing a new initiative not in the President’s budget, which supports a long-term strategic goal for the IRS to be one of the best places to work in the Federal Government. The Board’s recommendations for Infrastructure Initiatives are presented in Table 7.

TABLE 7.—OPERATIONS SUPPORT ADJUSTMENT AND INFRASTRUCTURE INITIATIVES RECOMMENDED BY THE OVERSIGHT BOARD

[In thousands of dollars]

	Amount	Portion due to the ACA implementation
President’s policy level adjustment .....	10,128	.....

<sup>2</sup>Treasury Inspector General for Tax Administration, *Annual Assessment of the Business Systems Modernization Program*, Reference Number 2010–2094, September 23, 2010.

<sup>3</sup>The United States Government Accountability Office, *High-Risk Series: An Update*, GAO–11–278, February 2011.

TABLE 7.—OPERATIONS SUPPORT ADJUSTMENT AND INFRASTRUCTURE INITIATIVES  
RECOMMENDED BY THE OVERSIGHT BOARD—Continued

[In thousands of dollars]

	Amount	Portion due to the ACA implementation
Infrastructure initiatives:		
Enhance security and disaster recovery .....	35,000	.....
Update integrated financial system .....	27,500	.....
Leveraging data to improve compliance .....	1,400	.....
Enhance physical security for employees .....	31,057	.....
Implement individual coverage requirement and employer responsibility payments ...	62,477	62,477
Attract, retain, and develop a quality workforce .....	20,000	.....
Initiative total .....	177,434	62,477

In relation to the areas where the Board believes more funding is needed for infrastructure initiatives than the President has requested, the Board is recommending an additional \$23 million for the initiative to enhance IRS system security and disaster recovery capabilities (bringing the total initiative request to \$35 million) and an additional \$15.6 million for the initiative to enhance the physical security for IRS employees and taxpayers at IRS office locations (bringing that total to \$31.1 million). The Board is also recommending an initiative of \$20 million to further develop a highly engaged IRS workforce.

*Enhance Security and Disaster Recovery Systems Capability*

The Board views its two recommendations around enhanced systems security/disaster recovery and enhanced physical security at IRS office locations as highly important to a more robust IRS enterprise risk management strategy. As recent events demonstrate, both natural and manmade catastrophes do occur, so the IRS needs to be prepared—given the critical role tax administration plays in the economic health of this country. Indeed, Homeland Security Presidential Memorandum has designated several core IRS tax processing systems as part of the Critical Infrastructure Protection (CIP) Program. In a similar vein, TIGTA in its most recent report to the Treasury Secretary on the top 10 management and performance challenges facing the IRS elevated “security” to the top challenge, in recognition of the difficult task the IRS faces in safeguarding a vast amount of sensitive financial and personal data and also protecting approximately 100,000 employees and more than 700 facilities.

The infrastructure initiative to enhance security and disaster recovery systems capability would address the IRS’ need to provide resiliency of four critical tax systems:

- Processing remittances;
- Processing tax returns;
- Processing refunds; and
- Responding to taxpayer inquiries.

The intent of this initiative is to move the IRS closer to its goal of having a disaster recovery time that does not exceed 12 to 36 hours, dependent upon the system disabled. The IRS’ current disaster recovery capability could leave some systems out of operation for days or even weeks at a time.

*Enhance Physical Security for Federal Employees*

This initiative will fund guard services for the IRS TACs during the filing season, a period when the IRS employees and taxpayers receiving assistance may be exposed to greater risk of dangerous situations. The initiative will also enable the purchase and installation of security equipment—cameras, screening equipment, and surveillance devices—as another strategy to address areas of vulnerability identified through a thorough security reassessment of all IRS facilities. This initiative will also support the IRS’ full participation on the Joint Terrorism Task Forces (JTTFs) and the Attorney General’s Advisory Counsels (AGACs). It will also train and develop agents to carry out assignments and rapidly follow-up on leads developed by the Garden City Counterterrorism Lead Development Center.

*Attract, Retain, and Develop a Highly Engaged Workforce*

The Board has approved a long-term strategic goal for the IRS to be one of the best places to work in Government, and will evaluate the IRS’ success in achieving

this goal by comparing its employee engagement score, as measured by the Office of Personnel Management's annual employee survey, to other Federal agencies. Successful achievement of the goal requires the IRS to be in the top quartile among the 14 largest Federal agencies by 2012, based on that employee engagement index score.

The Board believes that it is imperative that the IRS workforce be among the most highly engaged of all large Federal agencies for several reasons:

- The agency is vital to the Nation's economic security.
- More Americans interact with the IRS than virtually any other Federal agency, and the performance of the IRS' employees will have a direct bearing on whether taxpayers' transactions with the IRS are satisfactory.
- Studies have demonstrated that highly engaged employees are the most productive, and increased productivity will be asked of all Federal agencies.
- More productive employees will also lower taxpayer burden through improved timeliness, which studies have shown is a key factor in taxpayer satisfaction with IRS transactions.

Additionally, in the last 2 years, the IRS has hired a number of new employees to replace the growing number of retirees and to increase its enforcement staff. It has successfully recruited highly qualified employees, aided in part by higher unemployment. Retirement rates are expected to remain high in the future, so the IRS will need to continue to recruit highly qualified new employees to replace retired employees, and it must retain those employees it has hired and trained in the last several years. Improving economic conditions will make both these objectives more difficult.

Specific findings by a major IRS operating division indicate that there is a significant benefit associated with high employee satisfaction, all indicating a high degree of efficiency and productivity. Also, attrition by resignation for highly satisfied new employees is significantly lower than for the overall division population.

The proposed initiative will be used to fund activities that have a direct link to increasing and maintaining high levels of employee engagement for front line employees, especially those in mission-critical occupations who deal with taxpayers on a regular basis. Effective first-line management is a critical factor in developing a highly engaged workforce.

The Board is concerned with two issues that relate to developing effective front line managers. First, many highly qualified technical employees are reluctant to move into management. Second, although qualified employees may be highly skilled in their chosen area, they often lack the skills needed to be effective managers and to effectively develop and engage the employees they supervise.

Approval of this initiative would enable the IRS to:

- Eliminate the backlog of untrained front line managers;
- Ensure enough capacity to train new managers upon selection in all business units;
- Improve and expand readiness programs to provide a cadre of candidates to step into management positions;
- Revise the management curriculum to incorporate more e-learning and promote continuous learning; and
- Evaluate the effectiveness and impact of the IRS' leadership programs.

APPENDIX 1.—SELECTED MAJOR LEGISLATIVE AND ADMINISTRATIVE PROVISIONS THAT CREATED SIGNIFICANT CHALLENGES FOR THE IRS DURING THE 2007 THROUGH 2010 FILING SEASONS  
2007 FILING SEASON

Legislation/provision and impact(s) on filing season	Some related GAO/TIGTA audit findings
<p>Tax Relief and Health Care Act of 2006 Legislation extended certain existing tax deductions such as those relating to deductions for State and local sales taxes. This late-passed legislation forced approximately 1 million taxpayers to delay their return filing and any associated refund claim for about 3 weeks while IRS finalized its system programs and testing. Required taxpayers to make, and IRS to process, unique annotations on paper tax returns to claim certain deductions.</p>	<p>IRS improved most filing season services during 2007: electronic filing grew and several IRS Web site measures improved such as customer satisfaction; meanwhile, access to IRS telephone assistance and the associated IRS response accuracy were comparable to the prior year (GAO-08-38). Overall, the IRS correctly implemented the key tax law and administrative changes with no significant delays in returns processing during the 2007 filing season (TIGTA report: 2007-40-187). The IRS provided taxpayers with effective access to telephone service; however, the quality and level of service for Spanish applications were lower than those in English (TIGTA report: 2007-40-160). There were some areas in which taxpayers did not take full advantage of the benefits the tax law and administrative changes provided (TIGTA report: 2007-40-187).</p>
<p>Telephone Excise Tax Refund (TETR) Allowed for a one-time refund on income tax returns applicable to all who paid telephone excise tax, regardless of obligation to file a tax return.</p>	<p>The IRS received fewer TETR requests from individuals than expected; early data showed minimal impact on returns processing and taxpayer service (GAO-07-695). With some exceptions, the IRS successfully planned and implemented the TETR Program for individuals and businesses; this includes revising forms, developing strategies to educate taxpayers, and developing methods for taxpayers to estimate their TETR claim without burden of obtaining years of telephone bills (TIGTA reports: 2007-30-178 and 2008-30-091). Despite IRS efforts, much of the over-collected tax went unclaimed and unrefunded (TIGTA reports 2007-30-178 and 2008-30-091). The IRS did not scrutinize many questionable TETR claims by individuals because of competing priorities to examine other issues on returns (TIGTA report: 2007-30-178). The IRS effort to identify overstated TETR claims by businesses was ambitious; however, minimum selection criteria for some businesses were inconsistently applied (TIGTA report: 2008-30-091). A TIGTA survey indicated that 27 percent of preparers who did not compute the TETR claim for their business clients due to cost involved were not aware that the IRS had offered a simplified method to estimate the refund (TIGTA report: 2008-30-175).</p>

2008 FILING SEASON

Legislation/provision and impact(s) on filing season	Some related GAO/TIGTA audit findings
<p><b>Tax Increase Prevention Act of 2007</b>                      Legislation extended Alternative Minimum Tax (AMT) "patch" and certain AMT credit offsets.                      This late-passed legislation forced approximately 3 to 4 million taxpayers to delay their return filing and any associated refund claim for about 4 weeks, while the IRS finalized its system programs and testing.</p> <p><b>Mortgage Forgiveness Debt Relief Act of 2007</b>                      Allowed taxpayers to generally exclude from income forgiven mortgage debt used to buy or improve principal residence.</p>	<p>Overall, the IRS correctly implemented the tax law changes enacted late in the year with no significant delays in the processing of tax returns (TIGTA report: 2008-40-183).                      The IRS did not achieve its toll-free assistance and level of service performance goals because of the high volume of calls regarding the economic stimulus payments (TIGTA report: 2008-40-168).</p> <p>The amount of forgiven mortgage debt excluded from income could be significant (GAO-10-997).                      The IRS faced several compliance challenges in administering this complicated tax provision, including limited information on current IRS forms, and return on investment considerations on whether to devote limited IRS enforcement resources to enforce this provision (GAO-10-997).</p>
<p><b>Economic Stimulus Act of 2008</b>                      Mandated that the IRS send stimulus payments to more than 100 million households based on who filed a tax year 2007 during the 2008 filing season.                      Congressional passage occurred approximately 3 weeks after the start of the 2008 filing season.</p>	<p>As of June 13, 2008, the IRS had generated 129 million economic stimulus payments, totaling more than \$89 billion with an accuracy rate of 99.6 percent (TIGTA report: 2008-40-174).                      The first stimulus payments were issued via direct deposit on April 28, 2008 (TIGTA report: 2009-40-069).                      The IRS made significant efforts to ensure eligible taxpayers received their stimulus payment such as sending advance information notices to more than 130 million taxpayers who filed a tax year 2006 return, initiating outreach efforts to retired individuals and veterans who normally have no need to file a tax return, and initiating outreach efforts to individuals whose stimulus payments were returned as undeliverable (TIGTA reports: 2009-40-069 and 2008-40-100).                      Demand for telephone assistance related to the economic stimulus legislation was unprecedented and led to a significant reduction in IRS telephone service (GAO-08-916T).                      The IRS decision to reallocate hundreds of IRS collections staff to help address large telephone call demand resulting from economic stimulus legislation resulted in up to \$565 million in foregone enforcement revenue (GAO-08-916T).                      TIGTA identified \$1.2 million in false stimulus payments that were issued by the IRS in 2008, and another \$138 million that could be potentially released erroneously in 2009 unless the IRS made improvements in its fraud referral process (TIGTA report: 2009-10-049).</p>

## 2009 FILING SEASON

Legislation/provision and impact(s) on filing season	Some related GAO/TIGTA audit findings
<p><b>Economic Stimulus Act of 2008</b> Allowed taxpayers who did not receive the full stimulus payment during the 2008 filing season to receive the unpaid portion on their tax year 2008 return as a Recovery Rebate Credit during the 2009 filing season.</p>	<p>Overall, the IRS successfully planned the implementation of the Recovery Rebate Credit and issued approximately \$8.5 billion in credits to approximately 21 million taxpayers (TIGTA report: 2009-40-129). Taxpayers had difficulty determining whether they qualified for this credit and early in the filing season the IRS had already identified more than 5 million tax returns with Recovery Rebate Credit errors (TIGTA report: 2009-40-058). The IRS found the IRS calculation errors in less than 1 percent of the cases but also identified a programming error, which the IRS took immediate action to correct that could have potentially allowed almost 6 million taxpayers to erroneously claim nearly \$1.6 billion in credits (TIGTA report: 2009-40-129). Legislation did not provide the IRS with math error authority to prevent individuals without valid SSNs from receiving the credit at the time the returns were processed, and as a result the IRS provided more than \$27 million in credits to taxpayers without a valid SSN (TIGTA report: 2009-40-129).</p>
<p><b>Housing and Economic Recovery Act of 2008 (HERA)</b> Provided taxpayers a First Time Homebuyer (FTHB) credit of up to \$7,500 on purchase of home, but required them to repay the credit over 15 years starting in 2011 filing season. While the FTHB credit was initially contained in the HERA, it was subsequently expanded, and the repayment provision eliminated in most instances, under the American Recovery and Reinvestment Act of 2009. <b>American Recovery and Reinvestment Act of 2009 (Recovery Act)</b> Congressional passage occurred approximately 4 weeks after start of the 2009 filing season. Provided taxpayers a revised credit of up to \$8,000 on the purchase of home with need to repay only if home is resold or ceases to be primary residence within 3 years. Allowed small businesses to apply certain 2008 net operating losses against tax liabilities from the previous 5 years.</p>	<p>The IRS met many of its processing goals during the 2009 filing season, but telephone access remained low due in part to calls about tax law changes; despite the heavy call volume, IRS accuracy remained above 90 percent (GAO-10-225). The IRS had a successful 2009 filing season despite the unique challenges it faced (TIGTA report: 2009-40-142). The varied FTHB credit provisions within the HERA versus the American Recovery and Reinvestment Act may have confused taxpayers and also presented the IRS with significant challenges to ensure the credit was used correctly as authorized. (TIGTA report: 2010-41-069).</p>
<p><b>American Recovery and Reinvestment Act of 2009 (Recovery Act)</b> Provided Federal subsidies for State and local bonds, including Build America Bonds (BAB), through certain credit provisions.</p>	<p>The 2009 filing season provided challenges for the IRS due to the two significant tax laws that provided a new FTHB credit, and a massive bailout and tax relief package, which entailed 116 different tax provisions (TIGTA report: 2009-40-058). The Recovery Act posed significant implementation challenges for the IRS because it had more than 50 provisions, many of which were immediate or retroactive and had to be implemented during the 2009 filing season (GAO-10-349). The IRS responded quickly to the implementation challenges of the Recovery Act; however, that quick response entailed tradeoffs, such as not making some computer changes to collect data (GAO-10-349). Nearly 30,000 taxpayers may not have claimed the full amount of the FTHB credit to which they were entitled; the IRS agreed to contact the applicable taxpayers to inform them (TIGTA report: 2009-41-144). Despite the fact that the Recovery Act was enacted during the filing season, the IRS issued timely and clear guidance that helped foster compliance with the new NOL provisions; by the end of 2009, the IRS processed approximately 44,000 NOL claims totaling more than \$3 billion (TIGTA report: 2010-41-070). The initial guidance on bonds published by the IRS was quick, complete, accurate, and consistent with the requirements of the Recovery Act (TIGTA report: 2010-11-035). Generally, all complete requests for payment of Build America Bonds (BAB) Federal subsidies were processed accurately and timely by the IRS, and without indications of fraudulent or erroneous disbursements; as of September 2009, State and local governments received almost \$26.4 billion in funding through 315 BAB issuances (TIGTA report: 2010-11-083).</p>



2010 FILING SEASON

Legislation/provision and impact(s) on filing season	Some related GAO/TIGTA audit findings
<p>American Recovery and Reinvestment Act of 2009 (Recovery Act) Provided a Making Work Pay (MWP) credit to working individuals. Increased allowable credit amount for homeowners who make certain energy efficiency improvements.</p>	<p>The IRS dealt with a number of challenges during the 2010 filing season, including significant tax law changes such as the MWP credit (GAO-11-111). The IRS balanced its resources across filing season activities with improvements in some areas but fluctuations in others: electronic filing and IRS Web site visits increased, level of service to callers seeking live IRS assistance improved compared to 2009, and the accuracy of answers remained high; however, average wait time for telephone service increased compared to 2009, and millions of taxpayer refunds were delayed primarily because of the time needed to correct taxpayer errors associated with the MWP credit (GAO-11-111). The IRS implemented the MWP credit in accordance with the consent of the Congress by advancing it to taxpayers through a decrease in Federal income tax withholding rates (TIGTA report: 2011-41-002). The IRS initiated a significant outreach program to inform taxpayers about the change in withholding associated with the MWP credit and its potential to leave certain taxpayers underwithheld and owing taxes at the time they are due (TIGTA report: 2011-41-002). Despite IRS outreach actions, more than 13 million taxpayers were or will be negatively affected by the MWP credit withholding rate changes, including more than 1 million who may face an increase in their Estimated Tax Penalty amount (TIGTA report: 2011-41-002). A survey of taxpayers who appeared to be negatively impacted by the MWP credit withholding changes indicated that most were not aware of the credit or its effect on their taxes (TIGTA report: 2011-41-002).</p>
<p>Worker, Homeownership, and Business Assistance Act of 2009 Extended FTHB credit another 5 months (to April 30, 2010) and allowed a credit up to \$6,500 for certain long-time homeowners purchasing new homes. Provided the IRS with "math error authority" to deny erroneous FTHB credit claims upfront during the IRS return processing phase. Expanded and extended the NOL carry back provisions for businesses.</p>	<p>As of early 2010, the IRS still did not have the ability to identify individuals who received the FTHB credit but who would have some repayment requirements because the home ceased to be their main residence; the IRS was, however, developing a comprehensive strategy to address this issue (TIGTA report: 2010-41-086). In May 2009, the IRS implemented a number of controls to prevent inappropriate FTHB credits claims from being issued before the claims were processed; however, follow-up action by the IRS was still needed on fraudulent and questionable claims processed before the controls were implemented (TIGTA report: 2010-41-069). The IRS timely implementing procedures to identify and reject extended NOL claims inappropriately submitted by Troubled Asset Relief Program recipients, but was somewhat late in implementing controls to apply a limit on the amount of the loss carried back to the fifth year (TIGTA report: 2010-41-070). The IRS received millions of calls related to the MWP and the FTHB; approximately 9 percent of all calls received (GAO-11-111).</p>

PREPARED STATEMENT OF COLLEEN M. KELLEY, PRESIDENT, NATIONAL TREASURY  
EMPLOYEES UNION

Chairman Durbin, Ranking Member Moran, and distinguished members of the subcommittee, I would like to thank you for allowing me to provide comments on the administration's fiscal year 2012 budget request for the Internal Revenue Service (IRS). As president of the National Treasury Employees Union (NTEU), I have the honor of representing more than 150,000 Federal workers in 31 agencies, including the men and women at the IRS.

IRS FISCAL YEAR 2012 BUDGET REQUEST

Mr. Chairman, the NTEU strongly supports the administration's fiscal year 2012 budget request of \$13.2 billion for the IRS, a 9 percent increase of \$1.1 billion more than the current fiscal year 2010 enacted level. We believe that the President's request will allow the IRS to continue helping taxpayers meet their tax obligations, improve enforcement of the tax law and generate much needed revenue for the Federal Government.

We are particularly pleased the administration's budget request would provide critical increases for IRS enforcement and taxpayer service activities, and would allow the IRS to continue rebuilding its workforce which remains well below mid-1990 levels.

As in previous years, the NTEU also supports the budget recommendations proposed by the IRS Oversight Board which have generally called for additional funding above that requested by the administration. For fiscal year 2012, the Oversight Board has recommended \$13.5 billion in funding for the IRS. We would be inclined to support providing additional funding for the IRS above the administration's request and look forward to reviewing the details of the Board's recommendation.

TAXPAYER SERVICES

Providing quality customer service to the taxpayer is an important part of IRS efforts to help the taxpaying public understand their tax obligations while making it easier to participate in the tax system. Through a variety of channels, the IRS is able to provide year-round assistance to millions of taxpayers, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, the IRS.gov Web site, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites. These efforts have enabled the IRS continue raising the standard of service to America's taxpayers and assisted in efforts to improve voluntary compliance.

In fiscal year 2010, these efforts helped the IRS meet or exceed 83 percent of the taxpayer service performance targets. In addition, IRS taxpayer service activities were critical to its ability to deliver a successful 2010 filing season during which IRS employees processed more than 141 million individual returns and issued 109 million refunds, totaling \$366 billion and answered almost 36 million calls from taxpayers requesting information on new credits available to them. In addition, the IRS also provided in-person service at its 401 Taxpayer Assistance Centers (TACs) located around the country, for taxpayers to resolve tax issues and receive help to prepare their tax returns. In 2010, 6.4 million taxpayers visited a TAC, 3 percent more than in 2009. Walk-in service at TACs remains popular among elderly taxpayers, those with limited English and computer proficiency, and taxpayers without Internet access.

In addition, during the 2010 filing season, the IRS expanded hours of service at 16 geographically dispersed TACs, and seven were open every Saturday. In 27 locations, low-income taxpayers took advantage of IRS help in the preparation of both their State and Federal tax returns. The IRS held Open House events at 200 TACs and partner sites nationwide to help taxpayers prepare their returns and resolve their tax issues. As a result, more than 31,400 taxpayers were served and more than 7,700 returns were prepared at these events.

The delivery of a successful 2010 filing season by the IRS is all the more impressive as employees delivered these numbers while also being confronted by a variety of challenges presented by implementation of provisions in the American Reinvestment and Recovery Act of 2009, the Worker, Homeownership, and Business Assistance Act of 2009, and increased telephone demand for Economic Recovery Payment inquiries.

We were glad to see the administration's request of \$2.3 billion for taxpayer services acknowledges the good service that IRS employees provided to taxpayers in fiscal year 2010 while also recognizing that additional progress can be made. In par-

ticular, we strongly support the proposed additional funding to improve telephone level of service, improve the IRS Web site and provide a variety of new online services.

In fiscal year 2012, the IRS plans to increase the telephone level of service by adding resources to meet the ever-increasing demand and continuing to make efficiency improvements such as automated self-service applications that allow taxpayers to obtain information on less complex issues such as refund inquiries. These improvements will free up staff to deal with the more complex tax law issues stemming from the passage of new legislation. In addition, the IRS continues to study the effects of services it offers to taxpayers on the Internet, at walk-in sites, and on its toll-free telephone lines as well as exploring the relationships between taxpayer errors and unclear correspondence to aid in the development of new approaches to service.

The NTEU strongly believes providing quality services to taxpayers is an important part of any overall strategy to improve compliance and that the President's request for taxpayer services will enable the IRS to deliver another successful filing season, improve the responsiveness and accuracy of taxpayer service, and support IRS efforts to enhance taxpayer compliance.

#### ENFORCEMENT

Mr. Chairman, the NTEU believes a strong enforcement program that respects taxpayer rights, and minimizes taxpayer burden, plays a critical role in the IRS' efforts to enhance voluntary compliance, narrow the tax gap and reduce the deficit. In fiscal year 2010, the IRS enforcement efforts brought in almost \$58 billion in enforcement revenue, an 18 percent increase more than fiscal year 2009. In addition, other key IRS enforcement programs continued to show progress over fiscal year 2009. These include a 6 percent increase in collection case closures, a 20 percent increase in Automated Under Reporter (AUR) contact closures, an 8 percent increase in large corporate audits and an 11 percent increase in the number of individual return examinations.

That is why the NTEU was happy to see the administration's budget request would provide a \$462 million increase in funding for the IRS tax enforcement above the current fiscal year 2010 enacted level, including additional resources made available through a program integrity cap adjustment.

This increased funding will enable the IRS to continue strengthening current IRS compliance programs designed to close the tax gap in several areas, including: increasing compliance by addressing offshore tax evasion through more examinations and full implementation of the Foreign Account Tax Compliance Act (FACTA); implementing information reporting requirements approved by the Congress in 2008 to validate income reported by businesses by reconciling their income with their payment card receipts and third-party transactions; and improving tax debt collection coverage and collection processes. The proposal will also allow the IRS to continue to focus on compliance issues and new responsibilities arising from recent tax law changes included in major legislation, including the American Recovery and Reinvestment Act and the Affordable Care Act.

These investments in IRS enforcement programs are expected to generate \$1.3 billion in additional annual enforcement revenue, resulting in a return on investment (ROI) of 6.4 to 1, once new hires reach full potential in fiscal year 2014. In addition, investment in new enforcement initiatives will also encourage voluntary compliance, further increasing revenue. According to the IRS, the deterrence value of these investments and other IRS enforcement programs on voluntary compliance is conservatively estimated to be at least three times the direct revenue impact.

The NTEU strongly supports targeting additional resources to programs that would help close the tax gap, including new initiatives that deepen and broaden the IRS' focus on international tax compliance of high-net-worth individuals and entities. The IRS has demonstrated that targeted compliance resources more than pay for themselves through increased revenues, which has motivated past Congresses to target additional funds to these enforcement activities. In addition to generating additional revenue for the Federal Government, reducing the tax gap will help strengthen public trust in the fairness of the tax system which will positively impact voluntary compliance with tax laws.

#### PHYSICAL SECURITY

Mr. Chairman, as you know, last February, in what authorities believe was an intentional attack, a pilot crashed his small plane into a building housing almost 200 IRS employees in Austin, Texas, killing 1 employee and seriously injuring several others. This brazen and cowardly attack, serves as a grim reminder of the great

risk that the men and women of the IRS face each and every day in service of this country.

As one of the most public faces of the U.S. Government, the IRS and its employees often bear the brunt of anti-Government rhetoric and threats. According to the Treasury Inspector General for Tax Administration (TIGTA) which is charged with investigating threats and assaults against IRS personnel, more than 1,200 threat and assault cases were referred to TIGTA for investigation between 2001 and 2008. The cases resulted in more than 167 indictments and at least 195 convictions.

That is why the NTEU was happy to see that the administration proposed \$15 million to enhance physical security for IRS employees. This includes \$10 million to expand guard serve at Taxpayer Assistance Centers (TACs) during filing season, \$1.5 million to improve security at IRS facilities around the country, and \$3.9 million to provide additional resources to identify and investigate individuals or entities whose anti-Government or anti-tax rhetoric exhibit behavioral traits associated with domestic terrorism.

The NTEU believes these critical investments will enhance the overall security of IRS employees in the work place, while maintaining open access for the taxpayers that they serve.

#### CONTRACTING OUT

Mr. Chairman, the NTEU recognizes that in the current fiscal crisis, it is critical that the Federal Government look for ways to maximize its resources and to root out waste, fraud, and abuse wherever they find it. One way in which the NTEU believes that the Federal Government can best accomplish this is to reform the broken competitive sourcing process, and bring contracted work back in-house. By ensuring Federal employees are able to compete for work with contractors on an even playing field, and identifying areas in which the Government could perform this work more effectively and efficiently, the Federal Government will be better able to provide high-quality services and will save taxpayer dollars. The administration has already begun to reform Federal contracting by requiring Federal agencies to cut wasteful contract spending, reduce over-reliance on contractors, and improve oversight and accountability. These efforts are expected to result in \$40 billion in annual savings by the end of 2011 which could be used to ensure agencies have the necessary resources and staffing.

In recent years, the Congress has acknowledged the inherent flaws in the competitive sourcing process and has included language in year-end spending bills that prohibit the use of funds to begin new public-private Circular A-76 competitions for another year. The NTEU strongly believes the current A-76 competition moratorium should be continued for another year until further steps are taken to reform the broken competitive sourcing process that has eroded the ability of agencies to perform many critical functions, and has led to contractors performing work that should be performed solely by Federal employees.

In addition, we would strongly encourage the Congress to continue the current prohibition on the use of funds for private collection agencies through fiscal year 2012. The use of private collection agencies to collect tax debts has repeatedly been shown to be a waste of taxpayer dollars and lead to taxpayer abuse. The 2006 initiative resulted in widespread taxpayer abuse and a loss of almost \$5 million to the Federal Government, after subtracting program administration costs and commissions payable to the PCAs. While the IRS ended the private tax collection program in 2009, it still retains the statutory authority to revive the program in the future.

#### CONCLUSION

Mr. Chairman, thank you again for allowing the NTEU to provide our thoughts on the administration's fiscal year 2012 budget request for the IRS. We strongly believe that by investing in demonstrably effective enforcement and taxpayer service programs, the administration's request will allow the IRS to provide taxpayers with top-quality service, enhance voluntary compliance, narrow the tax gap, and reduce the deficit.

Senator DURBIN. Thank you very much.

As I mentioned in my opening statement, the IRS deals with a huge volume, processing more than 230 million tax returns and issuing more than 109 million refunds. It's an indication of the challenge that you face, and your people that you work with face, on a regular basis. And, of course, there are going to be cases

where people set out to defraud or cheat the Government in terms of filing these tax returns.

I'd like to call your attention to one that's received some attention over the last year or so. This is the providing of refunds to people who are serving in prisons across the United States. The Treasury Inspector General for Tax Administration reported that erroneous prisoner refund claims are on the rise—up of 44,944 claiming refunds of \$295.1 million in the year 2009.

Even though the IRS has been able to prevent large amounts of these refunds from being issued—256 million were rejected in 2009, this year of the study—the amount of false refunds issued still hit a high of \$39.1 million. Since 2004, when 18,103 false tax returns were filed, nearly \$123 million in fraudulent refunds have been issued to those serving in prison.

Now, I can think of a situation where someone serving in prison may be eligible for a refund. It could happen. But clearly, in this case we're dealing with those ineligible to receive refunds who are trying to defraud the Government. They aren't satisfied with being punished by sitting in prison. They are dreaming up new crimes—at the taxpayers' expense here—to try to defraud the Government.

And so let me ask you at the outset—I understand you've spoken to the U.S. Bureau of Prisons to try to make sure that we can have identification of those prisoners filing these returns. But I also understand that, when it comes to the State prison systems, that your authority to have this kind of information transferred will expire at the end of this year.

Can you tell me what's being done to stop these false claims by prisoners, and what more we can do to protect the taxpayers and the Treasury?

#### PRISONER CLAIMS

Mr. SHULMAN. Mr. Chairman, it's an issue we take very seriously and we've been focused on. The bottom line is, when we have the name of a prisoner, we can stop the refund from going out, and we do.

The problem is getting the data. And we signed last year a memorandum of understanding with the Federal Bureau of Prisons, so we'll get the data in a format we need so we can put screens in place to block the refund.

I sent letters out to the Governors of the 10 States that have the highest prison populations and the biggest problems here. We've since that time signed memorandums of understanding with seven of those States to get the information. We're in discussions with 17 other States. So, we've seen some progress with States getting us the information so we can block it.

We have a bigger problem with big counties and municipalities, because we need to get information from them. They've got budget constraints; and we need to get the information in a format we can use in December, so we can load it into our system, so that we can put blocks in place for the filing seasons.

What I would tell you—and I think the Inspector General recognized this in the last report—is, we're stopping more, we're detecting more, and we're screening more now.

Senator DURBIN. Are we prosecuting those who file false returns?

Mr. SHULMAN. The biggest hammer that we have is sending someone to jail. And these people are already in jail. And so, what we've been doing in these memorandums with States and the Federal Government—and this is authority you talked about—is sharing tax data, which generally we can't do under 6103 of the tax laws, so that officials can do things like have additional punishment in prisons. Wardens can put a prisoner in solitary confinement and things of that like. Because the people we generally block are people who are there for life. As you mentioned, there's a lot of prisoners who are married, filing jointly, who are due a refund. So, what we need to do is screen the return and make sure we're not hurting the spouse of a prisoner.

I think we've made a lot of progress. This year we've actually processed and done screens and follow-ups of 100,000 more returns. I added resources to the unit that does the screening. And so, all of this is moving in the right direction. And as long as we get the information, we can properly block these refunds.

#### IMPROPER CLAIMS

Senator DURBIN. In the infinite wisdom of a Member of Congress, we dream up new tax deductions and tax credits for perfectly valid reasons—at least in our opinion. And then it's up to you to try to make it work. And one of them related to tax credits for energy efficient windows, doors and insulation and geothermal heat pumps and solar water heaters. I probably voted for it. I would have if it were a separate vote. It sounded like a good idea.

For tax year 2009, taxpayers claimed more than \$5.8 billion of the energy credits which were included in the 2009 Economic Stimulus Recovery Act. Based on a review of a statistically valid sample of 150 tax returns, the Treasury Inspector General for Tax Administration was unable to confirm home ownership for 30 percent of that sample—45 of the taxpayers—which, of course, is required to claim the credit. So, there is, at least, a question mark going forward as to whether these 30 percent of the people who claimed this money were eligible for it.

In addition, the Inspector General identified 362 ineligible individuals who were allowed to erroneously claim \$404,578 in residential energy credits on their tax returns. These individuals included 262 prisoners—here they are again, now claiming that they deserve a tax credit for energy efficient windows in their prison cells, I guess—and 100 individuals under the age of 18 who were ineligible to file.

So, how do we get to the bottom of this—once again, with the prisoners, and, again, with those who are ineligible—to try to police the ranks and make sure that people aren't filing and claiming credits that they're not entitled to?

Mr. SHULMAN. I think there's a couple of things. This is a worldwide phenomenon. When people wanted to give incentives to spend when there was a major economic meltdown across the globe, people quickly used the tax system to push a lot of money out to help stabilize economies. The tax system is efficient, and there's already an annual interaction that happens every year with most Americans.

When we have time, we can properly set up filters, think this process through, engage with the industry, find out where there's potential leakage, find out what data we can get in, find out what data we can get through on our electronically filed returns, and then set up screens and filters. And we do that. For instance, in the report you referenced, we generally—this law happened very quickly, when we were trying to do some things—set up a set of filters. Our Inspector General—who provides incredibly valuable service, and we learn along the way, I think, both of us, as we go—recommended we put more filters in place while we were having dialogue on that report.

Some leakage occurred. We'd like to have zero leakage. There's going to be some leakage with any credits, because we're only going to be able to screen and follow up with a certain amount. But we do follow-up. And so, when things happen very quickly, sometimes more refunds go out the door that are questionable. Then we have an audit program where we can go audit, find out what's there, do follow-up, and close. If we have a lot more lead time, with more developed credits, we can set up the screens ahead of time.

But make no mistake—I think we're getting better at this, and we've a lot of sophisticated filters, and we stop the vast majority of fraudulent returns from going out. But if you're going to use the tax system, which is built on voluntary compliance, to achieve these goals we've got to get this balance right between getting refunds to people who are due them and rely on them, and blocking the bad ones, there's going to be some leakage. Our goal is to get that balance right—to narrow the leakage as much as we can.

Senator DURBIN. If—Senator Moran, just bear with me. I want to ask two questions to close this line here.

In the most egregious cases, when someone is claiming they're a homeowner and entitled to these credits and, in fact, they're not—

Mr. SHULMAN. Yes.

Senator DURBIN [continuing]. So, they are just clearly misrepresenting their eligibility for the program. It's not a math error. It's a clear misrepresentation. In those cases, when you detect them, is there follow-up in terms of penalties, fines, prosecution?

#### PENALTIES AND FINES

Mr. SHULMAN. Penalties, yes. Fines, yes. We have limited prosecutorial resources. We try to spend those resources on the places that are going to create the most long-term deterrence. Our Criminal Investigation Division is balancing things around money laundering, terrorist financing, preparer fraud, identity theft fraud, and very specific tax fraud. We try to allocate the resources appropriately.

So the answer is "Yes". And a lot of times, you'll see a scheme where one person puts a bunch of false claims in, files a return, comes back. An individual who claims \$1,000 credit for himself fraudulently usually will be fined in more of a civil context than a criminal context. But the bigger the crime, the more prosecution is likely to happen. And as you know, it's a partnership with the Justice Department and local U.S. Attorneys.

## IMPROPER CLAIMS

Senator DURBIN. So, we talked about these jail-cell taxpayers, and I've talked about this specific credit. If you could—the last question here—if you could take a look at the overall landscape, where do we find the most fraud—the most cheating going on in terms of people claiming what they are not entitled to under our tax code?

Mr. SHULMAN. You know, the tax code is incredibly complex. There's a fair amount of noncompliance. Some of it is confusion; some of it's fraud. The places we focus, which is where we think the most leverage is for the tax system to make sure we protect the fisc, is overseas and offshore tax evasion—people just parking assets overseas. I would say, where there's complexity is where people hide money and push the envelope.

We've been focused around preparer fraud, because we think it's a big point of leverage. If one preparer gets 1,000 taxpayers and encourages them to do something fraudulent, a lot of times the taxpayer is unsuspecting. If we can lock that down, it's a big link in the system.

And then refundable credits. In places where you can get a large tax credit, you find fraud. So, we did a lot of focus on the First-time Home Buyer Credit, where there was a big refundable credit that was temporary, that was quick. Earned Income Tax Credit—we put a lot of effort there, doing both civil and criminal follow-up. And then, this set of credits that you talked about, is where we put a lot of effort.

Senator DURBIN. Thank you.

Thank you, Senator Moran, for your patience.

Senator MORAN. Mr. Chairman, thank you.

## FRAUD DETECTION

Commissioner, following that line of questioning, how often is it that the IRS finds the fraud, as compared to an Inspector General's report, or a GAO report requested by the Congress? How actively engaged and how successful are you in ferreting out the problem with some, without some other agency pointing out the fraud or the challenge?

Mr. SHULMAN. Every tax return goes through a screen. We call it the Electronic Fraud Detection System (EFDS). It's our fraud filters. And it looks for, for example, returns that have the same address—100 returns that have the same address; big changes in income; not having the proper documentation attached or not including information in the return. We set filters and tolerances, frankly, based on resources. A lot of these are an indication that we need to follow up.

And so, we have civil units that call employers and say, "Was this person employed? Is this income accurate?" And then it kicks out to criminal, who develop schemes, and that feeds our criminal prosecutions.

What I would say is the GAO, our Inspector General, Congressional oversight all really help us by focusing on places where they think we've had too much leakage. I don't think there's been an in-



stance—at least since I have been there—where people have found more fraud in their investigation than we’ve actually blocked.

And so just to give you a sense of magnitude, our EFDS filters, screen filters, kick out between 1 and 2 million tax returns a year that we do follow-up on. We block every year and reject 2 million returns who have duplicate SSNs of either dependents or individuals. And sometimes it’s a transcription error, but sometimes it’s somebody trying to defraud the system. In EITC alone we protect \$4 billion annually through our enforcement efforts and blocking refunds.

We’ve got an incredibly active program there. But then it’s very helpful to have people overseeing the program, finding where they think there’s too much leakage, and we tighten—you know, it’s a continual evolution and tightening up. Frankly, the real fraudsters, they’re always testing our tolerances, sending things in to our systems. And so, we always have to be one step ahead.

#### PRISONER CLAIMS

Senator MORAN. Well, the two examples that Chairman Durbin indicated—the prisoner example—that’s something you would have known before we read about it in the paper?

Mr. SHULMAN. Well, sure, we’ve had extensive conversations. Look, it’s counterintuitive to your average American that a prisoner could get a tax refund, right? So it’s going to be in the paper.

Senator MORAN. It makes a story.

Mr. SHULMAN. I think the reality is, some prisoners can get tax refunds. We can’t just reject everyone. So we need to do screening.

If you look at the reports that say there’s been more, they also show that we’ve been screening more and blocking more and identifying more. It’s just the volume’s grown, so the gross volume of refunds were higher this year. The numbers, the percentages that we caught, the amount we caught and filtered, also grew exponentially. So, we were protecting a lot more money for the Federal Government. But, as a fraction, more was going out.

Senator MORAN. Okay.

#### E-FILING

You talked about e-filing and the savings that come from that successful program. Your sentiment—first of all, how much more potential is there for savings? Is there more, opportunity for more e-filing expected? And then second, you talk about the \$190 million in efficiency savings, reductions and nonrecurring activities. What does that mean in the budget and appropriations process?

Mr. SHULMAN. Sure. So, on e-file, just to tell you what we’ve done, we’ve shut down 5 of our 10 processing centers over the last 6 years. It hasn’t been popular with folks where those processing centers were. But, we’ve been very clearly reaping the savings of e-filing. Right now, we plan to get to 80 percent of returns e-filed. We’re at 75 percent. But, certainly, we’re going to look to reap more savings. So, we’re at 75 percent individuals e-filing.

Twenty years from now, my guess is the IRS won’t take any paper. We still take some paper. I am hoping that percentage is just going to keep going up, and that’s been a great success. Really working with the private sector, with individuals, to help them to

understand, we take data security very seriously, so nobody will be worried with those 1 billion returns that there's going to be any leakage.

Since I came here, and for every budget for the last 3 years that I've submitted, we've always included substantial savings. Because I believe, as the head of a big hundred-thousand-person agency, that you can always find efficiencies. You've always got to be looking at core operations, stopping operations that don't make sense so you can keep investing in the future and positioning yourself for the future.

This year, the \$190 million is some savings from e-file. We're just reaping the benefits and cutting down our processing operations; reducing IT infrastructure. We've been going through a process called Capability Maturity Models, which is pretty standard practice in the private sector, where I came from—I used to be involved in helping to run stock markets and run big computer systems—where you standardize your processes across your whole IT infrastructure. So you have standard ways of documenting IT, standard ways of developing requirements. You bring in an outsider to observe—there's a thing called the Software Engineering Institute that will come in and do random audits to see where it is. And we've been promising and reaping benefits, for the last 3 years, \$75 million a year by being more efficient and more standardized. And my Chief Technology Officer has signed up to those savings. And as long as I am here, you're just going to expect it, and we say we're just going to keep doing savings and adjusting core operations. It actually increases efficiency, while saving money.

And then we made some tough choices. This year we didn't automatically send out any paper 1040 forms. E-filing crossed a threshold. We just said, even in the past, if you filed a paper 1040, we didn't send you a paper 1040. I thought that was a self-fulfilling prophecy. So what we did instead this year, we sent you a postcard and said, if you really want your 1040, give us a call and we'll send it to you, but we're not going to spend \$10 million printing and sending out those.

We've cut contracts. I mean, this is just a series of issues. And to be honest, as the chairman said, we've been under a continuing resolution. Because there's inflation in things like rent and other things, it's an effective cut, and we've been doing aggressive cost cutting this year as well, beyond the things we listed in our 2011 budget as cost savings.

Senator MORAN. So, you would be requesting \$190 million more in your appropriations request in your budget request, but for those savings?

Mr. SHULMAN. Correct.

#### FILING METHODS

Senator MORAN. Okay. What percentage of American individuals file their return with the assistance of a professional preparer?

Mr. SHULMAN. About 60 percent last year. That number is actually going up. And then, another 20 percent use prepackaged software. So, 80 percent of people are using someone in the professional realm to help them with their tax return.

Senator MORAN. And if you use someone in the professional realm, is that an automatic e-file, or are there professional preparers who are still filing paper?

Mr. SHULMAN. One of the things that, if you come out to one of our processing centers you will see—which drives me crazy—is someone who clearly printed, had developed their tax return on a computer, printed it and sent it to us. And I have got people there typing it back into the system after it had already been typed in once. And there's 10 percent error. We've been reducing it, but that is how you have transcription errors, and it's just incredibly inefficient.

And so last year, the Congress passed an e-file mandate for preparers. We started, we've been phasing it in. It gave us authority to have any preparer who files 10 returns, to e-file. This year we started with preparers with 100 returns.

The good thing about e-file, and I think we did this right over the years, is we only got to a mandate once we really had momentum and almost everyone that we could convince voluntarily to send in electronically had gone in voluntarily. And so, over the years we've really increased e-file. And, now there's a mandate that says if you're a professional preparer and you're using software, you're going to need to e-file—unless you get a waiver from your client who really wants to send it in—

Senator MORAN. Thank you.

Mr. SHULMAN [continuing]. On paper.

Senator MORAN. Chairman, I have other questions, but I assume you do, too.

Senator DURBIN. Thanks a lot, Senator Moran.

#### TAX GAP

So we're in this debate here about our deficit and how we can come up with a savings of \$4 trillion over 10 years, or roughly \$400 billion a year, either in cutting spending or raising revenue. So, that is, kind of, the standard we're using—save \$400 billion.

It's estimated that \$345 billion of Federal taxes go uncollected each year—a noncompliance rate of 16.3 percent. This gross tax gap problem illustrates an enormous untapped resource of Federal revenue which can go a long way to dealing with our shortfalls and our deficit.

Most of the tax gap—\$285 billion out of \$345 billion, or 82 percent—is attributable to under-reporting tax liability, \$197 billion of that from individual income tax payers. Under-reporting can be the result of understated, or, can be understated income, improper deductions, overstated expenses, and erroneously claimed credits.

So, we went through a little exercise here on the Affordable Health Care Act and decided that one way we could capture some of these uncollected tax revenues when it came to small businesses was to have more reporting from them, more 1099s reflecting their business activity. Well, naturally, there was huge push-back from the business community saying, "More paperwork? Thank you, Washington. That is just what we need." And so we back-tracked and walked away from that and said okay, we won't tighten up the system at the expense of more paperwork.

So I want to ask you a pretty obvious question—with a pretty obvious answer, I am sure. Is there a way to address this tax gap without more reporting, more regulation, and more disclosure?

Mr. SHULMAN. Our statistics basically show, when you have information reporting and withholding—like the average American's paycheck, where it's withheld and the employer sends in the taxes and they get a refund—you have more than 99 percent compliance. Where you have some information reporting—mortgage interest deduction, 1099 reporting for interest on bank accounts that kind of thing—you've got 95, 96 percent compliance.

Where you have no information reporting—cash economies, think about cash businesses—the compliance drops. It's hard to do these compliance studies. I mean, they're by their nature inaccurate, because what you don't get, you don't know. But we go out and we do research. We do some statistically selected samples, et cetera—you get 50 percent, 60 percent compliance, 70 percent compliance, etc.

And so the real answer, and the place where there's leverage, is information reporting. But as you said, we set up our tax system as a voluntary tax system, where you're supposed to be fully forthcoming with the Government, report what you know, and then we keep an eye on things. The way that we can have broad coverage and keep an eye on things is having a third party do information reporting. It's the only efficient way to really go at the tax gap. But because it affects a lot of people with the tax code, it becomes pretty politically unpopular, like you said, for example with the 1099 reporting.

So that would have helped with the tax gap, but I fully understand both the politics and the reality around small businesses and what people are trying to do. And so, it's very tough.

There was an economist who's spent a lot of time in tax, who said the thing to remember about the tax gap is, it's like a deep shale oil reserve. This is not just money sitting there that's easily tapped. I mean, we've in many ways tapped the easy money. We actually have a very high tax compliance rate in this country. There's only five countries who study the tax gap, and we're as high as any of them. And the real way to go at the tax gap is better information reporting, but it brings with it some burden.

I do think there's some hope, though, as we get better at information technology, as information becomes more ubiquitous, it's lower cost and easier for people to do reporting. A great example is, this year we're implementing the credit card reporting, where we will get from credit card processors and people like PayPal, gross receipts that were paid into businesses. That's not a direct match, because some industries have high credit card receipts, some industries have lower credit card receipts. We'll look at those statistics, and it will be another factor we use in our audit selection and our compliance selection. And what we try to do with our compliance selection is spend time on noncompliant taxpayers and leave compliant taxpayers alone.

#### INFORMATION REPORTING

Senator DURBIN. So, I think you answered—I was going to ask a question, if other countries do it more effectively than we do, and

I think what you said, we're in the top five in terms of compliance. So I, if there is an example of another country that has figured out how to do this with greater efficiency in terms of collecting taxes owed, I would appreciate you sharing it.

The second part of it, though, I think you've alluded to. As, we started off with the premise, I receive a W-2 and my 1040 form from the IRS, sit down and dutifully fill it out, sign it, mail it back, and some human being receives this paper and goes through it to see if I'm telling the truth, or it looks presentable—that whole system is starting to change and become paperless. And information is flowing back and forth out without the traditional paper form.

So, are we looking, would you say, looking to a transformation in information gathering, as you just described with credit cards, that may make compliance easier? Where we may not be burdening local businesses so much with filing forms, but rather, having some basic flow-through of information that tells us what we need to know to assume, or, to assert tax liability?

Mr. SHULMAN. I think there's a couple of possibilities. I laid out kind of a long-term vision. We're still quite a ways away from there, because we've got to get some of our core technology done. We're trying to get W2s, 1099s loaded into our system before filing. Right now, the way that all the reporting happens is, those don't get loaded in the system until after people file. We can't use those as screens and blocks. And in some ways, it's back to this refundable credit question.

So I laid out a concept which basically asked if we could figure out a way to front-load the issue—could we potentially work with the private sector and make that information available to people? So rather than people scrambling around and trying to look through their files for those envelopes that say, "Important tax return information," and opening it up and sending it to their accountant or keeping a file of it, we could have a database that would have that.

When people filed, if there was a mismatch, we'd ask them to correct it. It would come in to us. We think we'd have a lot better compliance on the front end, and we'd create a lot less hassle for taxpayers. Right now, if you file and you get it wrong 6 months later you get a letter from us. You then have got to scramble to get your records, go back to your accountant, pay them again, and go through a second loop with us, which is probably unnecessary. So, I think that's one thing we can potentially do.

Second is, I actually started an office, reporting directly to me, on compliance data analytics, which is looking at our databases and trying to make sure we're really smart about the information we have, and that we're applying appropriate treatment streams. So, for instance, we're looking at things like, rather than sending out the standard four letters to taxpayers, which they get over time, making a call to a taxpayer immediately when they have a tax liability, to try to sort things out immediately, much like a credit card company. We are continually looking at data analytics to get better.

I think on the flow-through issue, it's more of a conceptual conversation, and one that we'd have to have a full vetting with the Congress. Because as the 1099 issue showed, people are very sen-

sitive about burden, but people are also sensitive about the voluntary nature of our tax system and the government not knowing too much about people. And so in our compliance job we want to get as much information as we can, again, so we spend time with noncompliant taxpayers and don't spend time with compliant taxpayers.

I just think in the world there's a lot more information available that can move around a lot quicker. And so, there could be less burdensome ways to get that information.

#### IT CAPABILITIES

Senator DURBIN. My last question is, do you have the information technology capability and the staff capability to develop what we've just discussed—a new generation of thinking about collecting and processing information that doesn't rely on the transfer of paper?

Mr. SHULMAN. Well we've had this conversation. I think we have the staff capability. I would put my IT leadership team that we've recruited up against anybody else in the Government or the private sector. We brought in a CTO who had been head of technology for Boeing, then EDS, then Visa International. He's built an incredibly strong team. And that's why we're able, even under tough budget circumstances, to finally finish this 20-year modernization of our account database.

With that said, where I came from, building big technology and the benchmarks in financial service are, you spend somewhere between 10 and 20 percent of your budget on capital investment in the future and technology, because you're all about processing money, getting information, serving people—which is a very similar model to ours.

Our capital investment, this President had asked to almost double it from 1.5 percent of our budget to about just under 3 percent of our budget. And so my objective view is that this agency, for 20 years, has been underfunded in investing in technology for the future, and we're just getting there. And we recognize the constraints that we're under. And I'm not going to come and make a request for a 10 percent increase in our technology budget, or 10 percent of our budget be technology investment. But I do think the future of running the Nation's tax system is all about investment in technology, investment in information, dealing with information well. And we're going to need to keep investing.

Senator DURBIN. Thank you.

Senator MORAN.

Senator MORAN. Mr. Chairman, thank you again.

#### 1099 REPEAL

The IRS 1099 issue that Chairman Durbin just talked about, as I understand, your budget request included \$23.3 million and 82 full-time employees attributed to that healthcare law's provisions. In light of its repeal, the IRS's request is reduced by that \$23.3 million, and a change in the 180, or, I am sorry, in the 82 full-time employees?

Mr. SHULMAN. Yes. Well, we've—that's dropped.

Senator MORAN. Good. That's the correct answer.

Mr. SHULMAN. We just saved some money.

#### SECURITY OF TAXPAYER DATA

Senator MORAN. And then, what Chairman Durbin was talking about caused me to want to inquire about the security. You mentioned about the voluntary nature, the concern by Americans about information, the Federal Government having information about them. How secure of a system do we have in place that protects taxpayer information from those who would want to either damage, harm the system, or steal the information for their own use?

Mr. SHULMAN. It is very secure and locked down. I always tell everybody when I was sworn in, I came back to the office, and the first briefing I had as IRS Commissioner was about protection of taxpayer data and data security. It's really built into the DNA of the IRS. There's laws that prohibit any of our individual employees from sharing information about any individual taxpayer with anyone, and we prosecute aggressively when anything happens.

From the just pure data security infrastructure, we've got extensive perimeter infrastructure around the Web, and we're continually monitoring that. We coordinate with all of the Federal and national securities agencies around this issue to make sure our infrastructure is protected.

And then for internal security, we have logs monitoring lockdown. And one of the things that I committed to when I came in, is that any new technology we put online is going to have 100 percent lockdown data security. You have to make choices about what you're going to do, but we're never going to make a choice around data security. So, we take this very seriously and we will stay focused on it.

#### ACA IMPLEMENTATION

Senator MORAN. One of the reasons—I'll shift topics—but, one of the reasons you would request more money and more personnel is the passage of the Affordable Care Act (ACA). Its constitutionality is being tested and, I assume, ultimately will be decided by the United States Supreme Court.

In light of whatever the uncertainty is, whatever the magnitude of that uncertainty is, is the IRS operating as if it is constitutional and going to be fully implemented? Is there a middle-of-the-road approach? I assume that you've not, or, you're not sitting there waiting for the constitutionality to be determined. But are you behaving any differently in the expenditure of money, the use of personnel, the focus of resources because of the constitutional challenge?

Mr. SHULMAN. Our job is to administer the laws that are on the books. And there's lots of tax laws that are in different places in the courts. This is obviously a high-profile one.

Just to be clear, our responsibility regarding the ACA is to administer traditional tax laws, issue refundable credits, and collect some of the revenues for that. And we are implementing the law on the books. We're in the process of implementing the ACA. If, obviously, if something happens and changes, we'll move. Similar to the 1099 issue that was in there, we would have been prepared to implement that. We had started to do a small amount of planning.

It got repealed, we stopped. But, we move forward with the laws that are on the books.

Senator MORAN. Timeframe wise, for implementation of ACA, what happens incrementally between now and 2014, or, its full implementation? Is there a series of additional use of resources, personnel and tax collections and enforcement?

Mr. SHULMAN. Yes. So, you can really break up the work that we're going to need to do on the ACA into the technology infrastructure, largely around the refundable credits, and connecting with the State exchanges. And that's our biggest lift between now and 2014. Technology and operations are 82 percent of the request in the 2012 budget. It's building the infrastructure to hook up with all the State exchanges, so when people are registering, they can find out their eligibility for tax credits, can sign up for tax credits, and then we have the information flows and the money flows with the insurance companies to be paying those on a regular basis.

And then there's some very bespoke tax law in the ACA that we need to implement immediately. There's a lot of immediately effective provisions, such as an excise tax on tanning salons, which was implemented. And right now we're doing outreach to them. There's 2,500 who have never had an excise tax. And so, we're doing outreach, education, and then we'll have a compliance program.

There's a credit for small businesses to help them buy insurance, or, I mean, to help them buy insurance for their employees. There's a tax on branded pharmaceuticals, which right now we've sent out the initial bills to the branded pharmaceutical companies for that. They're verifying the data. It's actually based on Government purchases. And so there's that kind of work, but that is a very small amount of the work.

#### ACA IMPLEMENTATION

So between now and 2014, there'll be the immediately implemented tax provisions and the work that has to happen there. But the big lift is building the technology infrastructure to be ready to interface with the State exchanges and the insurance companies around the refundable, the \$400 billion of refundable credits.

Senator MORAN. And that's required by, in 2014?

Mr. SHULMAN. Yes. The open enrollment will happen sometime in 2013. And if you scope a systems build, you basically need to lock down requirements, then do your build, and then do your testing. So, there's a huge lift in 2012 around requirements and build, because by 2013 you should be testing the systems.

Senator MORAN. Mr. Chairman, I think perhaps my last question is related to Nina E. Olson, the National Taxpayer Advocate's, testimony. And she raised a couple of issues for me talking about, really, customer service, taxpayer service.

#### TAXPAYER SERVICE MEASURES

The IRS's fiscal year 2010 management discussion analysis included the GAO's financial audit of the IRS. Collection related to enforcement activities totaled \$57.6 billion—a 34 percent increase more than 2004. By contrast, the Taxpayer Advocate noted that the IRS answered 74 percent of all calls from taxpayers seeking to speak with a telephone assister in 2010, as compared to 87 percent



in 2004. So, a decline of 13 percent—13 percentage points—or 15 percent. So, less access to the person, the live person on the phone, I think, is the point that's being made here.

And then, also, this sentence that, “the backlog of taxpayer correspondence and the tax adjustments inventory has jumped by 76 percent. The percentage of ‘uncontrolled’ correspondence received”—I don't know exactly what the word uncontrolled means, but it's in quotes—“‘uncontrolled’ correspondence received but not yet entered into the IRS computer system has increased by 134 percent. And the percentage of taxpayer correspondence classified as ‘overreach’”—again in quotes—“has increased by 135 percent.”

What are we being told, and what does that mean?

Mr. SHULMAN. As I mentioned at the beginning, I take very seriously that the vast majority of Americans are wrestling with a very complex tax code. Their interaction with us every year is: file a return and get a refund. And that's the last they hear of us. And I think about it, and I talk about it internally at the IRS, as we're a big financial service operation. We need to answer the phones, have a Web site that works, process paper, do all the things that you need to do to serve the American people.

The reality is, we're right now operating with about 1,200 less people than we were at the end of the last fiscal year because we were under a continuing resolution, and our budget was slightly reduced. We have allocations to taxpayer service and we have allocations to enforcement, and those enforcement allocations have a ring around them because they have a direct revenue-producing effect.

The reality, in my mind, is our taxpayer service operations also bring in revenue. When we answer a tax law question, help them get it right, help them e-file, or build computer systems so that we can do matching—all of those actually help get the \$2.3 trillion in revenue.

And we're trying to get a mix of investments.

The phone calls—I think we're actually doing okay. We actually need more people to answer more phone calls. We didn't get the request last year for 2011, and we've put the request in again for 2012, which will bring up that level of service.

I would point out, because we use this thing we call the level of service. That is not: “Is a taxpayer satisfied with the service?” We actually have a 96 percent customer satisfaction rating on our phone calls.

We've introduced a few things, which has dropped our level of service, but we think it increased satisfaction, like wait time. So, if a taxpayer calls and hangs up, that counts as a negative. So, that's not in the 74 percent. But we tell them, it's a 12-minute wait and you might want to call back at a less busy time.

Our paper inventory has been growing because we've had less people processing paper. We either put people on the phones or put people on paper. The way we try to balance it is, during March and April we try to make sure we answer all the phone calls we can, and so paper gets backed up, and then we catch up with paper as we go.

This request asks for more customer service folks because I mean, this, you've got to just process mail. You need people to proc-

ess it, open it up, look at it, make decisions about where it goes. Things fall out and into error. And so, that's gone down.

I've always leaned and said, around priorities, we want to make sure—technology is the key, and we need to make sure we invest in technology. Phones and paper and the Web—because we can move people off of paper and the phones if we can do more transactions on the Web—have to be invested in. And, frankly, the conversation that ends up happening with people who spend time with the budget is, there's always a tendency to put money into enforcement. And so, we really need—I think you're pointing out and the Taxpayer Advocate's pointed out—we need to keep an eye on a balanced program.

I think the President's budget is very balanced and will get us—will boost those numbers, and so we'll be serving people better. But make no mistake about it. In tough budget times, there's going to be longer wait times; we're going to answer less phone calls; paper is going to take longer.

#### IRS WORKLOAD

Senator MORAN. Are there more inquiries over time? More taxpayers are calling asking for help? Or less?

Mr. SHULMAN. It spikes based on different kinds of provisions. We had a huge spike in 2008, when we sent out the stimulus checks to every American. People were, "Where's my stimulus check? Am I going to get one?" et cetera. And phone call volume spiked and our level of service plummeted.

We've had kind of steady—and a lot of it depends on tax law, what's going to happen. If you look at our ACA request—just back to what you were talking about—technology and service, and making sure people understand how the rules work, what they're eligible for, is really the bulk of the request.

Senator MORAN. Thank you, Commissioner.

Thank you, Mr. Chairman.

Senator DURBIN. Thank you.

Senator KIRK.

Senator KIRK. Mr. Chairman, you, I, none of us have been accused of ever being in a tanning booth, so I think you can go forward with your outreach without us being affected.

#### TAX COMPLEXITY

I want to ask about, the Taxpayer Advocate has estimated that it takes Americans about 6 billion man-hours a year to comply with Federal taxes, which, when you divide it out by a full-time equivalent employee, is 3 million jobs, just complying with Federal law. When we look at how people then comply with this law, in a practical way, about 60 percent of the individuals are hiring someone else, about 29 percent of people are interacting with software. It's a hidden tax on Americans of, on average, about \$250 a year. And it's really an extra tax on top of the tax that you pay to comply with Federal law.

Have you thought about a way—it seems to be unreasonable to take 3 million Americans in a country of 300 million to comply with Federal law. Have you thought about a way to develop metrics and then, through software, get it down to 1 million Americans? Maybe

just 2 billion hours to comply with taxes, instead of 6 billion? This is an incredible drag on the economy.

Mr. SHULMAN. As you know, the Congress has the prerogative of passing the tax laws. Our job is to administer whatever laws the Congress passes and the President signs.

Senator KIRK. But let me interrupt you on that. There are two ways in the 21st century we can handle complexity. The ideal way, for me, is a flatter, fairer tax, like what the Gang of Six may come up with to lower the rate to 28 percent. But, you know, we'll see.

The other way is entirely in your hands—that an American doesn't pay TurboTax, doesn't pay H&R Block, simply logs onto the IRS Web site and fills out their taxes in an accurate, complete way in which the software is handling all of the complexity. And the amount of time spent complying with Federal law drops like a rock, which is entirely within your purview.

Mr. SHULMAN. We were talking earlier about my view, in looking at the metrics, that we've under-invested in IRS technology for more than 20 years—not in recent history. I will tell you frankly, we don't have the capability. We need to build some things like our core account database, and get that off of a 30-year platform, which we're finishing this year. And so, we need to build some core infrastructure.

We do have available forms that calculate, that people can go in and file online directly with us.

I think there's a big discussion about the IRS having software. And, frankly, it's an administrative discussion. But, it's also a political discussion about—

Senator KIRK. Your total budget is how much?

Mr. SHULMAN. Our total budget is about \$12 billion.

#### DIRECT E-FILING

Senator KIRK. About \$12 billion.

And, Mr. Chairman, I think something we might work on—because I think Americans would love not to pay TurboTax, and not to pay someone else, just, my guess, correct me if I am wrong—to develop a software package might be a \$20- to \$30-million job? And then put it up on the Web for free to Americans?

Mr. SHULMAN. I mean we've taken some looks at this. I don't think it's quite that simple. And I think there are choices—

Senator KIRK. Actually—

Mr. SHULMAN [continuing]. And I can show you some—

Senator KIRK. I would just disagree. It might actually be even more simple. Because the software companies have to make software calls based on checking with you. Whereas, you actually own all the rules and could be setting up the decision matrix, because you're the authority.

Mr. SHULMAN. I would love, Senator, to talk to you about this further, and I'm happy to talk about it here. I've got lots of letters on both sides of these issues about, should we be in the business of the sets of choices that are embedded in software, or shouldn't we?

What I would tell you is, we've got a very full plate right now of technology investments that we need to get done. That would

build the basic infrastructure to start talking about those things, and I would welcome a full-ranging discussion about it.

Senator KIRK. Chairman, I think it might be something that we can work together on.

Because it should—it shouldn't be a theological discussion for you. Your mission should be to make it as easy as possible to comply with Federal law. So, this argument inside your shop should end, like, in an hour.

And then you say, how do we then deploy software in a 21st century context so that an American gets on, puts in their basic data, files, doesn't pay anybody, and, you know, sort of like the E-Verify program—we're making it as easy as possible through an Internet 21st century solution to comply with Federal law.

Thank you, Mr. Chairman.

Senator DURBIN. Thank you, Senator Kirk.

Oh, a call from H&R Block.

Thank you very much for, thanks for—and I don't think that's, I think it's a valid question.

Mr. SHULMAN. Oh, I do too. I totally agree.

#### TAX COMPLEXITY

Senator DURBIN. If we can eliminate the middleman, the middleman will hate it, but it may save taxpayers money. And if, I'm looking for ease of filing, to be, put another idea on the table—which will never pass as a law—I may have mentioned to you that about 15 years ago my accountant died in Springfield. And I said, come on. I'm a lawyer. I'm a Senator. My tax return is not that complicated. I'll do it myself.

Every Member of Congress should be required to do their own personal income tax return. I guarantee, we'd have tax simplification overnight. Because I struggled with it for hours thinking, why is this so hard? You know? Because I don't do it. And I didn't have a computer program to work with. I was just using my wits. And it didn't turn out to be that impressive.

But the point I am getting to is that the complexity of the system, I think you would agree, needs to be continually reviewed, so that we can make it within the grasp of ordinary Americans to understand how their taxes are being calculated. If there's a mystery associated with it, there is a sense of injustice that I'm paying, and he isn't. You know, that sort of notion. And it is expensive as heck to get some of these tax preparers to do some pretty basic returns. So, I don't think Senator Kirk's off base that, and I want to follow through with it. Let's see what we can do about that.

Senator Moran, do you have anything more?

Senator MORAN. I do not.

#### ADDITIONAL COMMITTEE QUESTIONS

Senator DURBIN. Thanks for coming. I appreciate it, Commissioner Shulman. We'll have some written questions for you, and maybe some other colleagues will send some along. I'd appreciate it if you'd take a look at them. Thanks.

Mr. SHULMAN. Thank you very much.

Senator DURBIN. Thank you.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

REGULATING FEDERAL TAX PREPARERS

*Question.* Every year, more than one-half of all taxpayers pay someone else to prepare their Federal income tax returns. In calendar year 2009, the Internal Revenue Service (IRS) processed approximately 83.1 million individual Federal income tax returns prepared by paid preparers.

Last year, the IRS launched an oversight program to regulate paid tax return preparers. The purpose of this initiative is to improve the accuracy and quality of filed tax returns and to heighten awareness of preparer responsibilities.

All preparers must now obtain a preparer tax identification number (PTIN) and pass a tax compliance check. Additionally, over the next several years, the IRS plans to establish competency testing and continuing education requirements for preparers.

The fiscal year 2012 budget request for the IRS includes nearly \$17 million to increase oversight of tax return preparers. Among the efforts planned are ensuring that all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law. In addition, the IRS will develop a public database so that the public can ensure that their tax return preparer is registered with the IRS.

How is the paid tax preparer registration initiative progressing?

*Answer.* Since September 28, 2010, more than 708,000 individuals have obtained or renewed their PTINs in the IRS Tax Professional PTIN System. The IRS processed approximately 95 percent of the applications online and 5 percent on paper. Per newly implemented user fee regulations, applicants must pay \$64.25 annually for PTINs, consisting of \$50 to recover IRS costs and \$14.25 for third-party vendor costs.

On June 3, 2011 (scheduled to be effective on August 2, 2011) the IRS published the final regulations that amended Treasury Department Circular No. 230 (Circular 230).<sup>1</sup> Some of these significant changes include creation of a new registered tax return preparer designation, extension of Circular 230 ethical rules to all paid preparers, creation of new rules applicable to continuing education providers, expansion of the definition of practice to include return preparation, and numerous other revisions.

In April 2011, the IRS selected two vendors to develop/administer the competency testing and fingerprinting programs. Planning is underway for a projected fourth quarter 2011 launch of both programs.

In preparation for the launch of a new 15-hour annual continuing education requirement for certain preparers, the IRS is gathering information to help revamp the education provider approval process. The IRS is targeting the new continuing education requirement to begin January 2012.

*Question.* To what extent is the IRS identifying and weeding-out unscrupulous or unqualified tax preparers?

*Answer.* The IRS is developing a competency test for return preparers. Additionally, we will begin fingerprinting return preparers in order to conduct a suitability check. Fingerprinting will help to insure that those who are entrusted with taxpayer information do not have a criminal history of violations.

The IRS continues to develop and enhance various internal filtering tools to detect egregious behavior and inaccurate return preparation. These tools will enable the IRS to look at aggregate individual return information and extract unique characteristics, identifying likely questionable issues with a return preparer.

We are developing a comprehensive database to house all preparer information, with the goal of detecting unscrupulous return preparers and intervene early. This central database will enable the IRS to track preparers who try to avoid detection through changes in location and varying customers. The IRS is also designing a referral system to investigate and timely address taxpayer and stakeholder complaints surrounding return preparers. The IRS is also developing an aggressive and dynamic identification system for preparers who are being compensated to prepare returns, but who are not properly identifying themselves.

<sup>1</sup>Regulations Governing Practice Before the Internal Revenue Service.

Additionally, the IRS is taking steps to address preparer compliance. Beginning in July, we will begin contacting more than 100,000 preparers who prepared returns in 2011, but failed to follow the new requirements. These preparers either used outdated PTINs or Social Security Numbers as identifying numbers on the returns they prepared. Also, we have identified more than 1 million returns that appear to have been prepared by someone other than the taxpayer, and later this year we will begin to contact those taxpayers to determine who actually prepared these returns.

These initial efforts are part of a comprehensive effort to improve both the way in which the IRS identifies problematic preparers and the methods used to bring them into compliance. Unscrupulous preparers may attempt to elude the new requirements by not signing the returns they prepare. With better data and stronger analytical and historical knowledge, our goal is to ensure all preparers comply with the rules and that unscrupulous or unethical preparers do not continue to prey on taxpayers and the tax system.

*Question.* To what extent does the IRS plan to assess the impact of tax preparer registration on compliance?

*Answer.* The IRS has developed a Service-wide preparer compliance strategy to ensure return preparers adhere to the newly implemented registration requirements. The scope of the strategy is to review return preparer compliance with return filings, and includes e-file visitations, return preparer visitations, ghost preparer visitations, and preparer action cases.

This integrated strategy allows for a consistent implementation of the program and assessment of sanctions and/or penalties, and identifies the potential non-compliant/questionable paid return preparers. Through this strategy the IRS will identify the population of return preparers who may have chosen to ignore the new tax preparer registration requirements.

The IRS is also developing a proposed set of long-term strategic measures that will enable the agency to assess the effect of the program on tax compliance. To do this assessment, the newly established IRS Return Preparer Office (RPO) is working with Research, Analysis and Statistics and the Office of Compliance Analytics. The IRS plans to establish a baseline for the measures in 2012 and to track progress from that point.

Additionally, the IRS is developing a proposed set of short and long-term strategic measures that will enable the agency to assess the effect of the program. Short-term measures that could be used to assess program performance using current compliance metrics include the Discriminate Function (DIF) score,<sup>2</sup> the Dependent Database (DDB) Rule Breaks,<sup>3</sup> Risk Scores,<sup>4</sup> and accuracy measures.<sup>5</sup> With the exception of the risk scores, the IRS designed all of the other preceding metrics for purposes other than measuring preparer compliance. The newly established IRS RPO is working with the Office of Research, Analysis, and Statistics and the Office of Compliance Analytics to develop longer-term strategic measures. The IRS plans to establish a baseline for the measures in 2012 and to track progress from that point. The RPO will develop this more customized means for measuring the impact of the preparer program over the next 2 to 3 years.

*Question.* What performance indicators will be used to measure the impact of regulating paid preparers?

*Answer.* As noted above, the IRS is evaluating current compliance metrics to assess the near-term effect (6–18 months) of the program. Over time, the IRS will develop a more comprehensive measure of compliance that can be more directly tied to the specific education, service, and compliance initiatives of the program.

In the meantime, the IRS is developing indicators to measure the impact of regulating paid preparers. The IRS is still developing the suite of indicators. Indicators may include, for example:

- Number of tax preparers who apply for a PTIN;
- Number of applicants who pass/fail a background check;

<sup>2</sup>The DIF is a mathematical technique used to classify income tax returns as to examination potential. Under this concept, formulas are developed based on available data and are programmed into the computer to classify returns by assigning weights to certain basic return characteristics. These weights are added together to obtain a composite score for each return processed. This score is used to rank the returns in numerical sequence (highest to lowest). The higher the score, the higher the probability of significant tax change.

<sup>3</sup>DDB Rule Breaks are used to verify eligibility for the Earned Income Tax Credit by determining if a taxpayer is eligible to claim dependents.

<sup>4</sup>The IRS developed a risk-based scoring tool to identify high-risk preparers based on filters that look at volumes and ratios of certain deductions from various schedules.

<sup>5</sup>By using data collected during tax administration processes (math errors, Automated Underreporter (AUR), and the Examination Operational Automation Database), it may be possible to develop a limited accuracy/error rate for individual preparers as well as groups of preparers.

- Number of applicants who pass/fail a personal tax compliance check; and
- Incidence of paid preparers misrepresenting professional credential to the IRS and the public.

The above indicators are a small representation of those the IRS is developing. However, such indicators focus on outputs rather than on outcomes. The development of outcome measures requires additional time and experience.

The IRS has also developed a Service-wide preparer compliance strategy to ensure return preparers adhere to the newly implemented registration requirements. The scope of the strategy is to review return preparer compliance with return filings, and includes e-file visitations, return preparer visitations, identification of unregistered preparers, and visitations and preparer action cases. Measures are included for each of the strategy's components, which include letters and visits to high-risk preparers, program compliance checks, and identification of nonsigning return preparers.

This integrated strategy allows for a consistent implementation of the program and assessment of sanctions and/or penalties, and identifies the potential non-compliant/questionable paid return preparers. Through this strategy the IRS will identify the population of return preparers who may have chosen to ignore the new tax preparer registration requirements.

*Question.* Does the IRS expect to be able to cover the costs for the entire registration program with user fees or will you need to depend on existing compliance funds to support the program?

*Answer.* The user fees are necessary to recover the costs to the IRS that are associated with administering the PTIN application and renewal program, undertaking the fingerprinting and testing requirements, and providing the special benefits that are associated with obtaining a PTIN. The costs to the Government include:

- the development and maintenance of the IRS information technology system that interfaces with the prime contractor's systems;
- the development and maintenance of internal applications;
- IRS customer service support activities, which include development and maintenance of an IRS Web site and call center staffing; and
- personnel, administrative, and management support needed to evaluate and address tax compliance issues, investigate and address conduct and suitability issues, and otherwise support and enforce the programs that require individuals to apply for or renew a PTIN.

User fees do not support traditional compliance activities. In fiscal year 2012 the IRS requested funding for initiatives that focus on preparer activities and utilize traditional enforcement actions currently conducted by IRS personnel.

#### BUDGET CONSTRAINTS AND FORECAST IN THE FACE OF CUTS

*Question.* In the final continuing resolution enacted for fiscal year 2011, funding for the IRS was maintained at the fiscal year 2010 enacted level, which was \$487 million below the requested level.

What initiatives planned for fiscal year 2011 were put on the back-burner as a result of the reduced level?

What are the consequences of deferring or not being able to address the resource needs contemplated in your fiscal year 2011 funding request?

*Answer.* Due to the reduced funding in fiscal year 2011, the IRS will not realize the projected new hires who would have reached full performance potential by fiscal year 2013; therefore, the IRS will collect \$1.9 billion less in Federal revenues per year due to a diminished ability to fairly enforce tax law. As a rule of thumb, for every \$1 spent on additional enforcement initiatives, the IRS would have collected about \$7 in revenue or more at full performance, so these cuts actually add to our Federal deficit. American taxpayers will also see a diminished level of telephone service as a result of these cuts. Specifically, the following initiatives were put on the back-burner as a result of the reduced level:

*International.*—Without the funding to hire additional staff, the IRS estimates that it will not collect an additional \$812.2 million in enforcement revenue that would have been collected once the new fiscal year 2011 hires reached full potential in fiscal year 2013. Furthermore, the IRS was unable to increase data capture from certain paper returns that would have improved identification of abusive transactions using complex enterprise structures, and was unable to increase the capacity to support law enforcement efforts to investigate and address multi-jurisdictional tax evasions.

*Examination.*—Without the additional planned staff in field examination, specialty tax (matters that involve the excise, estate and gift and employment tax programs), correspondence examination and Automated Underreporter, the IRS

estimates that it will not collect an additional \$659.6 million in enforcement revenue that would have been collected once the new fiscal year 2011 hires reach full potential in fiscal year 2013.

*Collection.*—Without the additional staff the IRS planned to hire in field collection and the Automated Collection System (ACS), the IRS estimates that it will not collect an additional \$474.4 million in enforcement revenue that would have been collected once the new fiscal year 2011 hires reached full potential in fiscal year 2013.

*Increase Telephone Level of Service (LOS).*—Without the additional funding, the IRS will deliver a 71 percent LOS in fiscal year 2011, instead of the 74 percent LOS achieved in fiscal year 2010.

*Question.* The IRS has outlined a handful of ambitious high-priority performance goals for fiscal year 2012. These include achieving 4.5 million document matching closures (where the IRS information does not match taxpayer reported information), ensuring 80 percent of individual taxpayers receive refunds on a 5-day cycle in the new customer account engine database; attaining an individual income tax filers' American Customer Satisfaction Index score of 70 percent; improving telephone level of service to 80 percent; and raising the individual e-File rate to 76 percent.

How might these goals and your proposed IRS priorities for fiscal year 2012 be impacted and IRS operations affected if the additional resources you seek aren't addressed given the austere fiscal projections?

*Answer.* Without the funding requested in fiscal year 2011 and fiscal year 2012, the IRS will have to delay/reduce program priorities, identify alternative funding sources, and/or decrease base resources in other programs to implement mandatory legislation, such as the Foreign Account Tax Compliance Act, Merchant Card and Basis Reporting, Tax Return Preparer, and the Affordable Care Act. Furthermore, the IRS may be unable to:

- Deliver an 80 percent telephone LOS;
- Replace the outdated Web portal environment and provide additional online services to taxpayers;
- Expand global high-wealth coverage, and further its global presence and pursuit of offshore tax and financial crimes;
- Increase coverage in ACS and Offers in Compromise collection programs;
- Develop a comprehensive and integrated compliance strategy for administering refundable credits and addressing refund schemes;
- Address increasing workloads in Appeals and Counsel;
- Enhance security and disaster recovery systems capability;
- Upgrade the Integrated Financial System;
- Improve compliance by leveraging data;
- Enhance physical security for employees; and
- Continue migration from an aging tax administration system.

#### CAPTURING ADDITIONAL SAVINGS

*Question.* The IRS found \$75 million in savings for 2012 through reductions in information technology (IT) infrastructure. These savings were identified through a systematic process to which several staff were dedicated.

Can the IRS apply this systematic approach agency-wide to identify more savings?

*Answer.* The IRS uses a variety of approaches to identify savings, including soliciting ideas from front-line employees, establishing task forces of agency subject-matter experts, conducting analysis of existing programs, streamlining existing processes, and directing detailed analysis to determine the need and the effectiveness of each program. In addition to the approaches listed above, in the annual internal instructions and guidance for the budget submission, the IRS will continue to look to the business units to identify specific and achievable savings and efficiencies.

*Question.* What is your reaction to the suggestions by the Government Accountability Office (GAO) that the IRS may be missing savings opportunities and that the costs of conducting periodic reviews on other select aspects of the budget, targeting areas with high potential for savings and efficiencies, could be offset by the savings that are identified?

*Answer.* The IRS remains committed to exploring additional areas for savings and efficiencies as is evidenced by the identification of \$190 million in savings and efficiencies in both the fiscal year 2011 and fiscal year 2012 budgets, and will continue to employ new approaches to identify opportunities for further savings, balancing the cost with the expected benefits.



## IMPROVED UTILITY OF BUDGET REQUEST: GAO RECOMMENDATIONS

*Question.* Because of the size of the IRS's budget and the importance of its service and compliance programs for all taxpayers, the subcommittee requested that the GAO to review the fiscal year 2012 budget justification for the IRS.

In its April 11 report (GAO-11-547), the GAO stresses that several of the open matters for the Congress or recommendations to the IRS have the potential to increase revenue or savings if implemented.

To improve the usefulness of the budget request for the IRS, the GAO recommends that the IRS take the following four actions:

- further expand efforts to systematically identify savings and efficiencies as part of its budget development process on a periodic, but not necessarily annual, basis;
- report in its budget justification how savings beyond projections were used. The amount of explanation provided should correspond to the amount of the savings;
- provide cost estimates for individual legislative proposals in future budget justifications; and
- include measures of cost and schedule performance for major IT systems in Operations Support, such as it does for Business Systems Modernization (BSM).

What is the IRS's reaction to the findings and recommendations of the GAO?

*Answer.* The IRS appreciates and agrees with many of the GAO recommendations. The IRS agrees to the following:

- Continue to expand efforts to systematically identify savings and efficiencies throughout the budget process;
- Include in future budget submissions actual savings and to identify how additional savings beyond projections are utilized;
- Provide costs for individual legislative proposals in future budget submissions for those proposals received in sufficient time to prepare the cost estimates; and
- Provide cost and schedule performance for major IT systems in Operations Support in future budget submissions.

*Question.* Are the GAO's proposals for enhancing your budget presentation reasonable ones and worthwhile for inclusion in your fiscal year 2013 budget submission?

*Answer.* The GAO's proposals for enhancing the IRS budget presentation appear reasonable and the IRS will strive to include them as a part of the fiscal year 2013 and future budget submissions.

## MEASURING RETURN ON INVESTMENT (ROI)

*Question.* In this year's congressional budget justification, the IRS estimates the ROI for six proposed new enforcement initiatives.

The fiscal year 2012 budget includes \$339 million in new IRS enforcement initiatives, which raise \$1.3 billion in revenue annually at full performance. This is a ROI of 4.5 to 1 when new hires reach full potential in fiscal year 2014.

The GAO has consistently recommended that the IRS compile actual ROI outcome data that could be compared to the original projections.

How much progress has been made developing actual ROI's to measure the effectiveness and success of initiatives previously funded to determine if the anticipated revenue was reaped, exceeded, or fell short of projections?

*Answer.* The IRS has made progress in measuring the effectiveness and success of the fiscal year 2009 and fiscal year 2010 initiatives. The IRS is able to compare the actual revenue collected (adjusted for the late hiring of the fiscal year 2009 and fiscal year 2010 initiative staff) to the projected revenue expected from the initiatives' hires in the three major enforcement functions—Examination, Collection and AUR. As the table below shows, in fiscal year 2010, the enforcement revenue collected exceeded fiscal year 2009 collections by \$8.7 billion, or \$7.5 billion once initiative revenue is removed. The large increase in fiscal year 2010 can be attributed to several factors—new initiative hires, closing of several large cases, and continued implementation of better case selection and case analysis tools.

[In millions of dollars]

Actual enforcement revenue collected	Fiscal year 2009	Fiscal year 2010	Additional revenue collected (fiscal year 2010—fiscal year 2009)	Fiscal year 2009	Fiscal year 2010	Revenue projected from initiatives <sup>1</sup>	Revenue collected above/below prior year level
Examination .....	17,446	23,563	6,117	179.5	414.7	594.2	5,522.8
Collection .....	26,871	29,105	2,234	58.7	258.9	317.6	1,916.4
AUR .....	4,569	4,924	355	47.4	239.8	287.5	67.5
Total .....	48,886	57,592	8,706	285.9	913.4	1,119.3	7,506.7

<sup>1</sup> Adjusted for staggered on-board of hires.

*Question.* The IRS is currently developing a methodology to compare actual costs to projected costs so that a ROI can be calculated for the three major enforcement functions.

Would it not be prudent and helpful to determine the extent to which your revenue forecasts were accurate and the yield was realized?

*Answer.* The IRS agrees it would be ideal if the IRS could determine the exact accuracy for its revenue forecasts.

It is important to recognize the actual revenue collected is affected by many external and internal factors such as the economy, implementation of new legislative proposals, enforcement resources, changing priorities, and implementation of new case selection and case analysis tools.

*Question.* Assuming that the Congress is able to provide these resources as requested and that the IRS proceeds with the initiatives as planned, how will we know whether this was a wise investment?

*Answer.* The specific answer depends on the initiative. Some initiatives relate to short-term revenue-producing activities, which can be measured by program performance and compliance results. Others are longer-term and strategic, with a larger payback in the long-run, but are more difficult to measure in the early years. In either case, the IRS articulates, for each initiative, suggested measures or indicators for what the initiatives will deliver, which can serve as the basis for evaluating these initiatives after the fact.

#### IT FUNDING: COST AND SCHEDULE INFORMATION

*Question.* The IRS seeks \$2.67 billion for IT funding in fiscal year 2012, of which \$333.6 million (12.5 percent) is for BSM and the \$2.3 billion (87.5 percent) is for Operations Support.

The IRS funds 155 IT systems. Of these, about 31 are considered “major,” each having an overall life-cycle cost of greater than \$50 million or an annual budget of greater than \$5 million. The other 124 systems are “non-major.”

The GAO’s review of the systems funding justification notes the lack of cost and schedule performance information for the bulk of the IT funding.

Can the IRS undertake the formulation and submission of better estimates for at least some of the major systems?

*Answer.* The IRS plans to provide cost and schedule performance for major IT systems in Operations Support in future budget submissions. A Treasury and OMB reporting system for all major IT investments already contains the cost and schedule data. In the future, the IRS will utilize an extract to provide the information for the congressional justification.

*Question.* What factors or circumstances hamper the IRS’s ability to develop such estimates?

*Answer.* As part of budget formulation process, the IRS currently develops high-level estimates of cost and schedule for each major and nonmajor IT investment. Once the Congress enacts the fiscal year appropriations bill, the IRS completes the process by developing the more detailed cost and schedule plans. The timing and resources required hinder the IRS’s ability to develop more detailed estimates before the enactment of appropriations.

During the initial design stage, the IRS uses a tool to produce a Rough Order of Magnitude (ROM) estimate. After that ROM exercise, the IRS follows-up with a rigorous estimation analysis, updated during the passback cycle. On average, a full costing exercise takes 55 business days, three full-time equivalents and participation of multiple IRS business unit representatives. This analysis can be completed prior to the enactment of the appropriation, but generally would not be captured in time for inclusion with the budget submission.

Each year the IRS identifies in the internal budget formulation process new IT investments required to implement legislation and other IRS strategic priorities that become part of the President’s budget request. The IRS submits proposals and develops cost estimates based on past experience with similar projects. The IRS includes cost estimates by major category (i.e., labor, contractor costs, equipment, software, etc.) in the cost tables that are part of each initiative justification.

Once the Congress appropriates funding for the new IT projects, the IRS develops detailed requirements, cost and schedule information. This information is available at ITDashboard.gov.

#### VOLUNTEER INCOME TAX ASSISTANCE (VITA) SCOPE EXPANSION

*Question.* Almost all businesses (more than 90 percent) start as a sole proprietorship or self-employed businesses. Unless incorporated or part of a partnership, self-employed business income is subject to taxation through calculations performed on

“Schedule C” (or C-EZ). Each year, approximately 20 million self-employed businesses file a Schedule C or C-EZ.

In August 2010, the IRS, in partnership with the National Community Tax Coalition and Self-Employed Tax Initiative, launched the Schedule C VITA Pilot for the 2011 tax season.

The pilot is designed to determine the feasibility of restructuring IRS policies governing self-employment tax preparation at VITA sites. The 12 VITA sites involved in the pilot are exploring the expansion of service delivery to low-income, self-employed individuals.

What are the preliminary results of the Schedule C VITA pilots?

Answer. There are 24 sites participating in the Schedule C VITA pilot. Preliminary results indicate a total of 3,216 Schedule C returns filed at those 24 pilot sites from January 1 to June 6, 2011.

*Question.* When will a complete assessment be available?

Answer. The IRS will share the complete assessment with participating stakeholder partnerships, education, and communication partners by July 31, 2011. Additionally, the IRS will have a summary of the results by mid-August.

*Question.* Does the IRS plan to extend and expand the pilot more broadly to other VITA sites to expand the program reach to small businesses?

Answer. The IRS is still waiting for the final report results.

#### CONCLUSION OF HEARINGS

Senator DURBIN. This will conclude the hearings for this fiscal year and the subcommittee will stand in recess.

[Whereupon, at 11:34 a.m., Wednesday, June 8, the hearings were concluded, and the subcommittee was recessed to reconvene subject to the call of the Chair.]