

**WRITTEN TESTIMONY OF
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COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
SENATE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
ON THE FY 2015 IRS BUDGET
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I. INTRODUCTION

Chairman Udall, Ranking Member Johanns and Members of the Subcommittee, thank you for the opportunity to appear before you today to update you on the IRS' performance under our current funding levels for Fiscal Year (FY) 2014 and to provide you with an overview of our FY 2015 Budget and what we hope to accomplish with those resources.

The IRS is vital to the functioning of government and to keeping our nation and economy strong. We support the nation's tax system by providing taxpayer service to help people understand and meet their tax responsibilities while ensuring enforcement of the tax laws. The agency plays a unique role in government, and resources invested in the agency lead to significant revenue increases for the nation.

In FY 2013, the IRS collected \$2.9 trillion in gross revenue to fund the federal government, approximately 91 percent of all federal receipts. Moreover, for FY 2013, we processed more than 147.6 million individual income tax returns and issued more than 118 million refunds to individual taxpayers totaling nearly \$314 billion. This is a tremendous accomplishment, especially given that processing such a high volume of returns is an annual occurrence for this agency. It is important to remember that this does not happen automatically or by accident, but occurs as a result of the efforts of our highly experienced and capable workforce.

The IRS has made major progress since FY 2010 in finding hundreds of millions of dollars in cost savings and efficiencies. However, even with these savings, the FY 2014 IRS budget approved by Congress continued a funding shortfall for the agency that has major implications for taxpayers and the tax system, both for this year's tax season and beyond. It is important to note that the IRS continues to operate at near sequestration levels, with the agency's FY 2014 funding less than one percentage point above FY 2013 levels. Our current level of funding is

clearly less than what the agency needs, especially to provide the level of taxpayer services the public has a right to expect.

This year, millions of taxpayers continue to see longer wait times on the phone to get basic questions answered and resolve tax issues, though IRS employees are working diligently to reduce those wait times as much as possible. Further, as a result of fewer staff and reduced enforcement activities, the IRS estimates it will not be able to collect billions of dollars in enforcement revenues. The IRS is committed to carrying out its core responsibilities and working to preserve the public's faith in the essential fairness and integrity of our tax system, yet continued funding reductions will pose serious challenges to these efforts.

The IRS remains committed to being as efficient as possible and spending taxpayer dollars wisely, and we will continue to find savings wherever we can. At the same time, the FY 2015 President's Budget will allow us to invest in strategic priorities so that we can continue to fulfill our dual mission of strong enforcement of the tax laws and excellent customer service.

To summarize, the Budget funds the following activities and programs: improving service to taxpayers; increasing our efforts against refund fraud, especially fraud caused by identity theft; making our compliance efforts more strategic, using new tools, data and capabilities to conduct a balanced enforcement program; and investing in advanced technology to enhance both service and enforcement activities. The IRS will also continue to implement and administer tax-related provisions of major legislation, including the Foreign Account Tax Compliance Act (FATCA) and the Affordable Care Act (ACA).

In discussing our budget situation, we recognize that there has been a loss of confidence among taxpayers and particularly within Congress in regard to the way we manage operations, particularly the management problems that came to light last year in the section 501(c)(4) area. One of my responsibilities is to ensure that we are minimizing risks and quickly solving management and operational problems that may arise, so that Congress can be confident that when we request additional funding the money will be used wisely. Taxpayers provide the funds we receive and they deserve to be confident that we are careful stewards of those resources.

Despite the limits on our resources, I remain impressed with the professionalism and commitment of our workforce. Our employees have continued, throughout these challenging times, to perform critical work for the IRS and the nation – helping people understand and meet their tax responsibilities while ensuring enforcement of the tax laws. They are making every effort to ensure a smooth experience for taxpayers despite the funding shortfall.

II. IRS PERFORMANCE: FY 2013 AND CURRENT FILING SEASON

Through both taxpayer service and enforcement programs, the IRS remains committed to making the tax laws easier to access and understand and to improving voluntary compliance and reducing the tax gap – the difference between taxes owed and taxes paid on time. Taxpayer service supports and protects the trillions of dollars in revenue that come into the Treasury each year voluntarily from taxpayers by helping them understand their obligations under the tax law. Enforcement pursues those who evade or misrepresent their tax responsibility.

Filing Season

One of the most important activities the IRS undertakes each year is delivering a smooth and successful filing season. The IRS delivered another successful tax filing season in 2013, rising to the challenges posed by tax legislation enacted on January 2 of that year. The filing season began on January 30, 2013, less than one month after the passage of legislation that affected more than 600 tax products needed for the filing season. The IRS took the necessary steps to minimize disruptions for taxpayers, including working around the clock to update our forms and computer systems.

As noted, during 2013 the IRS processed more than 147.6 million individual income tax returns and issued 118.7 million refunds totaling almost \$314 billion. In addition, IRS employees responded accurately to 95.7 percent of tax law questions and 96.0 percent of taxpayer account questions. Largely as a result of the ongoing decline in agency funding and the late tax law changes, for FY 2013, the telephone level of service for taxpayers trying to reach the IRS' toll-free lines dropped to 60.5 percent, the lowest level since FY 2008. That means that approximately 40 percent of taxpayers who called were unable to reach an IRS employee.

The 2014 filing season, which began on January 31, started strongly and ran very smoothly. Through April 11, 2014, the IRS received more than 112 million individual income tax returns and issued more than 85 million refunds for approximately \$234.5 billion.

Our level of phone service has appeared to improve this filing season as compared to the average for FY 2013. We have been able to maintain a level of phone service of around 70 percent so far, meaning that about 70 percent of taxpayers who called this filing season got through to the IRS. One reason may be that the volume of calls to our toll-free lines is actually down somewhat. We believe that is largely because there were no significant tax law changes enacted in 2013 and because tax return processing has gone relatively smoothly. In addition, we continue to provide more resources to taxpayers on our website, which we believe offers an alternative to the phone. However, increases in volume will negatively impact these results, and we expect that for the year we

will drop below 70 percent and end up closer to last year's 60.5 percent. We will continue to monitor telephone service levels and work to maintain as high a level of phone service as possible within our resource limitations.

An area of concern this year is the amount of time people have had to wait to get in-person help at our Taxpayer Assistance Centers (TACs). We have had reports from field staff of taxpayers lining up outside TACs well before the centers open in the morning to make sure they receive service the same day. We also have had reports of people waiting 90 minutes or more to be helped once they arrived inside the TAC and taken a number for service. Unfortunately, given our resource limitations we have few options to drive down these wait times.

Taxpayer Service

Providing taxpayers with top-quality service and helping them understand and meet their tax obligations remained top priorities for the IRS in FY 2013. During FY 2013, the IRS updated forms to help taxpayers comply with filing requirements, converted forms for visually impaired taxpayers, and translated more tax products into multiple languages. In addition, the IRS continued its effort to redesign taxpayer correspondence in plain language and in a consistent format to make it easier for taxpayers to understand their obligations.

The IRS continued to provide alternative service options in FY 2013 by increasing the amount of tax information and services available on IRS.gov. In FY 2013, taxpayers viewed IRS.gov web pages more than 1.87 billion times as they used the website and mobile applications to obtain forms and publications, get answers to tax law questions, and check the status of their refunds.

Taxpayers used the "Where's My Refund?" online tool in 2013 nearly 201 million times to check refund status, an increase of 51.6 percent from 2012. Last year, the IRS enhanced the "Where's My Refund?" tool to allow taxpayers to find out when their tax return was received, when the refund was approved, and when the refund was sent.

The IRS also deployed a new telephone and web tool called "Where's My Amended Return?" in both English and Spanish that allows taxpayers to check the status of their Form 1040X amended tax returns for the current year and up to three prior years. The tool also provides taxpayers with other information, such as when their amended return was received, adjusted, and completed, as well as specific information regarding offset conditions, such as a previous IRS tax liability or a past due obligation.

The IRS continues to improve and expand on its outreach and educational services through partnerships with State taxing authorities, volunteer groups, and other organizations. Volunteer Income Tax Assistance (VITA) and Tax

Counseling for the Elderly (TCE) sites provide free tax assistance for low-income individuals, the elderly and disabled, and individuals with limited proficiency in English. In FY 2013, more than 91,800 volunteers prepared 3.4 million federal returns, 95.3 percent of which were filed electronically, and more than 2.5 million state returns. The IRS also teamed up with its national partners to offer a remote filing method – Facilitated Self-Assistance (FSA) – at VITA sites. More than 82,000 FSA returns were filed at the 330 VITA sites offering the FSA remote filing model.

I am pleased to report that the IRS' technology efforts in relation to improving taxpayer service recently received public recognition. In March, the Excellence.gov Awards Program sponsored by the American Council for Technology and the Industry Advisory Council recognized the IRS' Virtual Service Delivery (VSD) program for Excellence in Customer Experience. VSD technology units allow face-to-face contact between IRS employees and taxpayers at remote sites through two-way video conferencing. These units help the IRS resolve taxpayer issues remotely at understaffed and unstaffed Taxpayer Assistance Centers, Taxpayer Advocate Service sites, and Low Income Taxpayer Clinic locations.

With the IRS budget now in its fourth year of relative decline, significant effects on taxpayer services will become more apparent in FY 2014. The IRS has had 11,000 fewer people working during the 2014 filing season than it had in 2010 while processing the largest number of tax returns in the agency's history.

In addition to our concerns about the overall level of phone service noted above, we estimate that taxpayers may see average wait times of 25 minutes per call, compared with 10 minutes in 2010. Given current resources, we also expect that it will take longer for us to respond to taxpayer correspondence. Historically, 70 percent of letters we receive have been answered within 30 days, but we expect that more than half of all correspondence this year will take more than 45 days to answer.

As Forbes magazine recently noted, a reduction in IRS funding that erodes service levels "punishes" taxpayers.

Tax Compliance

In FY 2013, as a result of the impacts of sequestration and furloughs, the IRS delivered key enforcement programs well below historical levels. Total individual audits fell 5 percent from 1.48 million in 2012 to 1.40 million, while audits of high-income individuals declined from 179,000 to 172,000. This translated to an individual coverage rate below 0.9 percent, an historical low. Likewise, business return audits dropped 13 percent from 70,000 to 61,000.

Collections related to all enforcement activities totaled \$53.3 billion in FY 2013, an increase of \$3.1 billion over FY 2012. This was the fourth consecutive year the IRS exceeded \$50 billion, for a total IRS-wide return on investment (ROI) of \$4.8 to \$1. Most of the increase came from a \$2.6 billion rise in revenue from our Appeals function which, due to the timing of the Appeals process, generally relates to examinations occurring in previous years. Revenue from the Collection function, the levels of which also frequently rise and fall in tandem with the overall health of the economy, increased by nearly \$1 billion in FY 2013.

While the overall receipts from enforcement increased in 2013 compared to the prior year, the total is still down by more than \$4.3 billion from four years ago. The reason for this decline is primarily due to a decline in revenue from audits, which dropped nearly \$400 million in FY 2013 to \$9.83 billion, the lowest level in a decade. This decline in audit revenue is attributable to a decline in the number of returns audited.

We are concerned the decline in core enforcement activities during FY 2013 that was noted above is expected to continue in FY 2014, given the ongoing challenging budget environment. For example, we expect audits to decline by an estimated 100,000 from FY 2013 and the number of collection activities to decline by an estimated 190,000.

Despite the circumstances, the IRS has made significant progress in a number of major enforcement areas. One of these is international compliance. Strategic enforcement efforts and the parallel Offshore Voluntary Disclosure Program (OVDP) give U.S. taxpayers with undisclosed offshore assets or income an opportunity to become compliant with the U.S. tax system and avoid potential criminal charges. The OVDP has resulted in more than 43,000 disclosures and the collection of about \$6.5 billion in back taxes, interest, and penalties since the program was first established in 2009.

The IRS also continued to focus on service and compliance activities in regard to tax return preparers. Return preparers play a key role in increasing taxpayer compliance and strengthening the integrity of the U.S. tax system. The IRS requires anyone who prepares or assists in preparing federal tax returns for compensation to have a valid Preparer Tax Identification Number (PTIN). PTINs allow the IRS to collect more accurate data on who is preparing returns, the volume and types of returns being prepared and the qualifications of those doing return preparation. Additionally, PTIN data is essential in determining where to direct compliance and educational outreach efforts for erroneously prepared tax returns. The IRS recently held a successful PTIN renewal season, offering enhanced PTIN system usability, troubleshooting tips, and other tools. As of March 2014, the number of valid PTINs totaled approximately 677,000.

In FY 2013, the IRS continued to educate and inform return preparers on tax law compliance in a number of ways, including: making visits to more than 3,000

return preparers around the country, including 300 compliance visits to preparers who handled large numbers of returns claiming the Earned Income Tax Credit (EITC); and addressing preparers who were found to have made egregious errors through education and outreach and through a variety of methods to ensure appropriate penalties and/or sanctions were imposed.

A critical area of focus involves stopping erroneous claims for refundable tax credits, particularly the EITC. We are concerned that the improper payment rate has remained unacceptably high throughout the program's history. Therefore, we initiated a major review of our activities in this area earlier this year. If Congress enacts the proposal in the Administration's FY 2015 Budget to provide the IRS with greater flexibility to address "correctible errors," we will have additional tools to stop erroneous claims and, as a result, we believe we will be able to make a real reduction in the improper payment rate.

The IRS criminal investigation program examines potential criminal violations of the Internal Revenue Code and related financial crimes such as money laundering and tax-related identity theft fraud. In FY 2013, the IRS completed 5,557 investigations; achieved a conviction rate of 93.1 percent; maintained a Department of Justice case acceptance rate of 95.5 percent, which compares favorably with other Federal law enforcement agencies; and obtained 3,311 convictions.

Refund fraud related to identity theft continues to be a major focus for us and touches nearly every part of the IRS. In FY 2013, the IRS continued to focus on a comprehensive and aggressive strategy to identify and combat tax-related identity theft. Last year, the IRS conducted a number of activities in this area. These included: issuing Identity Protection Personal Identification Numbers (IP PINs) to more than 770,000 taxpayers for the 2013 filing season; conducting 191 identity theft outreach events with tax and accounting practitioners, the general public, and the media; and working with victims to resolve and close more than 963,000 identity theft cases.

Business Systems Modernization

IRS modernization efforts during FY 2013 continued to focus on building and deploying advanced information technology (IT) systems, processes, and tools to improve efficiency and productivity. FY 2013 modernization successes included the following:

- The IRS' Customer Account Data Engine 2 (CADE 2) posted more than 139 million returns and issued more than 111 million refunds totaling \$281 billion during the filing season. Daily processing and posting of individual taxpayer accounts – which improved on the prior system of weekly processing and posting – enabled faster refunds for millions of taxpayers.

- Modernized e-File (MeF) Release 8 deployed for the filing season and was the sole e-file platform used as the IRS processed 224.7 million individual returns, and 16.8 million Business Master File returns.
- The IRS launched the Information Return Document Matching program and began selecting casework in January 2013. This program matches new information returns, such as Form 1099-K, Payment Card and Third Party Network Transactions, with both individual and business tax returns to identify potential income underreporting or non-reporting.
- The IRS launched a new web portal that improved taxpayer access to IRS.gov. The Integrated Enterprise Portal accommodated a 22 percent increase in visits and a 6 percent increase in page views in FY 2013 compared to FY 2012.

Looking ahead, we believe that IRS IT operations in FY 2014 will suffer a significant negative impact from the continuing tight budget environment. We anticipate that FY 2014 funding will not be sufficient to address critical technology infrastructure needs such as: additional improvements to IRS.gov; new identity theft prevention tools; and upgrades to the basic computer software used by our employees that are needed to reduce system vulnerabilities.

Implementing Enacted Legislation

Within its budget constraints, the IRS nonetheless has an obligation to carry out the legislative responsibilities Congress has approved over the last several years, particularly ACA and FATCA. Implementation activities involving both statutes carried out in FY 2013 will evolve and continue through FY 2014 and into FY 2015.

With regard to ACA implementation, I am pleased to be able to tell you that the systems and processes that the IRS developed to support enrollment in the new Health Insurance Marketplace were launched on schedule and are working as planned. We continue to focus on two significant provisions that go into effect in 2014: the premium tax credit and the individual shared responsibility provision. These two provisions will have a profound impact on IRS forms and procedures beginning with the 2015 filing season, and will require additional taxpayer services and education activities.

Preparation is already well underway to modify forms and instructions, enhance education and outreach to taxpayers and their advisors, and update our systems and processes in time for the 2015 filing season. The IRS is also focusing on ensuring that returns that erroneously or fraudulently claim refundable premium tax credits (or fail to reconcile advance payments of the credit) are efficiently identified and addressed using Marketplace information available during the filing season as well as the ever-improving IRS tools used for all returns to address errors and fraud.

Another major initiative is implementation of FATCA, which is an important new tool in our offshore compliance efforts. FATCA requires foreign financial institutions (FFIs) to report information to the IRS about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Withholding requirements under FATCA go into effect on July 1, 2014. It is important to note that legal restrictions in some countries prevent FFIs from fulfilling the reporting, withholding and account disclosure requirements. For that reason, Treasury, with assistance from the IRS, is advancing an intergovernmental approach to FATCA implementation that is focused on bilateral agreements that address these legal impediments, simplify practical implementation and reduce the costs to FFIs. As of last week, there were 28 signed Intergovernmental Agreements. In addition another 27 jurisdictions had been publicly identified as having reached agreements in substance, bringing the total number of countries considered to have agreements in effect to 55.

The IRS FATCA registration website opened in August 2013 to allow financial institutions to begin to enter data. In January 2014, financial institutions were able to begin submitting their electronically signed FATCA agreements. Going forward, one of the IRS' biggest challenges involves having the resources to build and maintain systems that can effectively process all the incoming data. Beyond building these systems, we also will need additional staff to analyze the information and develop compliance programs around the new data.

Exempt Organizations

The IRS is continuing the efforts it began in FY 2013 to implement broad managerial and operational improvements in the determination process for tax-exempt status. In this work we are focusing on applications for recognition of tax-exempt status under both sections 501(c)(3) and 501(c)(4).

We continue to address the issues and concerns surrounding the determinations process for section 501(c)(4) applications. In FY 2013 and continuing into this fiscal year, the IRS has made important progress in responding to the recommendations made by the Treasury Inspector General for Tax Administration (TIGTA) in a May 2013 report describing problems with the processing of these applications. As of the end of January 2014, the IRS completed action on all nine TIGTA recommendations contained in that report.

Our responses to the TIGTA recommendations include the actions we have taken to reduce the inventory of section 501(c)(4) applications, including the group of 145 cases in the "priority backlog" – those that were pending for 120 days or more as of May 2013. As of March 13, 2014, 126 of those cases, or 87 percent, have been closed. Of the closed cases, 98 of them were approved, including 43 organizations that took advantage of a temporary self-certification procedure we offered in summer 2013. Of the remaining 28 closed cases, most

were closed either because the organization withdrew the application or it failed to respond to our questions. To date, three applications have been formally denied. The 19 cases still open generally fall into one of two categories: either the taxpayer has asked for and received additional time to respond to our questions, or the case is being litigated. None of these 19 organizations opted to accept the self-certification procedure used by 43 organizations to obtain prompt approval of their applications.

Also consistent with the response to the TIGTA recommendations, draft proposed regulations were released in November 2013 that are intended to provide clarity in determining the extent to which an organization's political activity is consistent with tax-exempt status as a social welfare organization. I believe it is extremely important to make this area of regulation as clear as possible, not only because it will help guide the IRS in proper enforcement, but because it will also give a better roadmap to applicants and help those that already have section 501(c)(4) status understand the applicable standards and properly administer their organizations.

As Treasury has noted in the past, the central purpose of any Notice of Proposed Rulemaking is to solicit public comments on proposed regulations, and we intend to consider all public comments we have received on these proposed regulations before moving forward in the regulatory process. Indeed, we received more than 150,000 comments on these proposed regulations, which is a record for an IRS rulemaking comment period. In addition, while I do not control the regulatory process, I am committed that any final regulation should be fair to everyone, understandable and easy to administer. It is also important that every taxpayer be confident that, whenever they interact with the IRS, they will be treated the same as any other taxpayer, no matter what their beliefs, what organizations they belong to or whom they voted for in the last election. Taxpayer trust in the integrity of the IRS is our most important asset, and my primary goal is to do whatever is necessary to restore whatever trust has been lost as a result of the inappropriate criteria used to scrutinize some 501(c)(4) applications.

Improving the section 501(c)(3) application process has been another significant area of focus for our agency, and we have been working diligently to make the process less burdensome for applicants in a number of ways. We presently have a backlog of 60,000 section 501(c)(3) applications, many of them well over a year old.

Our Exempt Organization (EO) group consistently receives more than 60,000 applications per year, consisting primarily of applications for section 501(c)(3) status. The agency has experienced a substantial rise in applications since 2010, due in large part to automatic revocations of tax-exempt status that occurred under the 2006 Pension Protection Act beginning in 2011, and the subsequent requests for reinstatement, which have added more than 50,000 cases to EO's workload since FY 2010.

We have taken a number of actions to deal with the backlog in 501(c)(3) applications. On January 2, 2014, the IRS issued Revenue Procedure 2014-11, which makes the reinstatement process more efficient for organizations whose status was automatically revoked and allows a majority of revoked organizations to use a streamlined process to apply for retroactive reinstatement of their exempt status.

Looking beyond the issue of automatic revocations, the IRS has recently developed another way of making the determination process more efficient for section 501(c)(3) organizations. The Interactive Form 1023, Application for Recognition of Exemption under Section 501(c)(3), which was made available online in September 2013, should result in more complete applications. This will thus reduce processing time by minimizing the IRS' need to request additional information to make a determination.

We have also taken all applications that were more than a year old as of last fall and devoted the necessary resources to resolving virtually all of them in the next months. We also are working to have no applications still pending at the end of this year that have been filed more than nine months earlier. Ultimately, we want to process all applications within a six-month time frame, with a backlog of less than 30,000 cases at any time.

To make this possible we are also examining the feasibility of creating a streamlined application process for certain organizations seeking tax-exempt status, in particular small organizations that pose a low risk of noncompliance. The goal is to come up with a new procedure this summer that is more efficient without introducing major risks into the system for approving applications. These streamlined applications could be processed in a matter of weeks rather than months.

III. THE ADMINISTRATION'S FY 2015 BUDGET REQUEST

The budgetary constraints under which the IRS has been operating since 2010 continue to pose very serious challenges to our efforts to enforce the tax laws and provide excellent customer service. Our FY 2014 enacted appropriation was \$11.29 billion, which is more than \$850 million below the FY 2010 funding level in nominal dollars, or over \$1 billion in real dollars. This represents a 7 percent cut in our annual budget since 2010 while the total population of individual and business filers grew by more than 4 percent over the same time period.

Essentially, the federal government is losing billions in revenue collection to achieve budget savings of a few hundred million dollars. In general, the IRS estimates that for every \$1 invested in the IRS budget, it produces \$4 in enforcement revenue, which is a \$4-to-\$1 return on investment to the American

taxpayer. This year, for example, the IRS estimates it would have returned to the Federal government over \$2 billion more in collections had we received the remaining \$500 million that our budget was cut as a result of the sequester.

The solution to the funding problems faced by the IRS begins with the President's FY 2015 Budget request, which, with the inclusion of the program integrity cap adjustment and the Opportunity, Growth and Security Initiative, totals \$12.64 billion. This is approximately \$1.35 billion above the FY 2014 enacted level of \$11.29 billion. This amount includes a \$480 million program integrity cap adjustment to vitalize tax compliance and a \$165 million additional investment through the Opportunity, Growth and Security Initiative to deliver performance enhancements that taxpayers deserve.

The aim of the President's proposal is twofold. First, it is designed to reverse the erosion in the IRS budget over the last several years. In so doing, it will help taxpayers get the service they expect. It will also strengthen compliance in key areas, such as international tax compliance, high-wealth individuals and flowthrough entities, in large part by halting the recent declines in the number of key enforcement personnel. Longer term, the proposal also positions the IRS well for the future by allowing the agency to invest in necessary basic infrastructure, as well as advanced technology.

The Budget request also provides funding to: implement enacted legislation; enforce return preparer compliance; expand criminal investigation capabilities; address compliance issues in the tax-exempt sector, including employee retirement plans, exempt organizations, and direct-pay bonds; and provide appropriate and balanced coverage by improving examination audit and collection coverage rates.

In regard to compliance, increased resources for IRS enforcement programs yield direct, measurable results through activities that provide a high return on investment. It is important to point out that this request includes a \$480 million program integrity cap adjustment that will reduce the deficit through above-base funding for high-return tax enforcement and compliance programs, of which \$5 million will be transferred to the Alcohol and Tobacco Tax and Trade Bureau. The \$475 million requested for the IRS FY 2015 enforcement initiatives funded through this program integrity cap adjustment is expected to generate nearly \$2.1 billion in additional annual enforcement revenue once the new personnel hired reach full potential in FY 2017. At full performance, these resources requested for enforcement initiatives are expected to generate a return on investment of nearly \$6 to \$1, not including indirect deterrence effects estimated to be at least three times the direct revenue impact. Over the 10-year budget window, the proposal is expected to generate \$52 billion in additional revenue while costing \$17 billion, thereby reducing the deficit by \$35 billion.

It is fair to ask what value the American taxpayer would receive for the increase in funding requested by the President of approximately \$1.2 billion over the FY 2014 enacted level. Let me detail for you how the IRS intends to spend these additional funds in various categories:

Improve taxpayer service: \$211 million. This additional funding will allow the IRS to meet the expected increase in demand for taxpayer services in FY 2015. Combined with Opportunity, Growth and Security Initiative resources, the additional funding will allow us to answer about 12 million additional calls from taxpayers seeking our help, including taxpayers seeking assistance in regard to the ACA, and will cause our level of phone service to exceed 80 percent. It also includes \$19 million that will be invested in advanced technology to further expand and improve the services taxpayers receive when they call the IRS. For example, this additional funding will allow the IRS to enhance its automated phone system to let taxpayers elect to be called back instead of waiting on hold, and will allow customer service representatives to call up immediate displays of taxpayer information on their computers, improving response time.

Prevent refund fraud and identity theft: \$65 million. This additional funding will allow the IRS to help more taxpayers who have been victims of identity theft resolve their cases. We will also invest in advanced technology to further our efforts in identifying potentially fraudulent returns, allowing us to reduce improper payments. We project that investments in these activities will protect nearly \$1.5 billion in revenue by FY 2017, an ROI of more than \$22 to \$1.

Address offshore tax evasion: \$57 million. This additional funding will allow us to expand our efforts to identify and pursue U.S. taxpayers with undisclosed offshore accounts. It will also help the IRS expand criminal investigations of international tax and financial crimes, and expand information gathering to identify those who promote or facilitate abusive offshore schemes. We estimate that this investment will enable the IRS to close an additional 6,600 cases and produce additional, direct annual enforcement revenue of approximately \$293 million once the new hires carrying out these activities reach full potential in FY 2017. That is an ROI of \$4.8 to \$1.

Expand audit coverage of individuals: \$98 million. This additional funding will allow the IRS to hire additional personnel to improve our examination efforts in regard to individuals. With these new resources, the IRS will be able to do more exams, match more documents to detect misreported or unreported income, and invest in advanced technology to make our work more efficient by, for example, using barcoding so that some paper documents we receive can be electronically processed. As a result, we estimate that we will be able to close an additional 243,000 individual examination cases. Through these activities, we expect to collect \$674 million more in direct enforcement revenue once the new hires reach full potential in FY 2017, an ROI of \$7.1 to \$1.

Expand audit coverage of high-wealth taxpayers: \$21 million. This additional funding will allow the IRS to hire more enforcement personnel to continue our focus on high-wealth taxpayers. This is a challenging area, as these taxpayers frequently operate complex enterprises containing many interrelated businesses that often have international components. We estimate that, with this investment, we will be able to close an additional 325 cases and produce additional annual enforcement revenue of \$243.9 million once the new hires reach full potential in FY 2017 – an ROI of \$11.3 to \$1.

Improve audit coverage of partnerships and flow-through entities: \$36 million. This additional funding will allow the IRS to hire additional staff to keep pace with this segment of taxpayers, the most rapidly growing portion of all tax returns filed. In particular, this will allow us to increase the number of tax examiners with specialized knowledge about partnerships. We estimate that we will be able to close an additional 2,800 cases involving partnerships and produce \$268 million more enforcement revenue annually once the new hires reach full potential in FY 2017, an ROI of \$6.8 to \$1.

Enhance collection coverage: \$67 million. This additional funding will allow the IRS to hire new staff to improve our efforts to work with taxpayers to collect back taxes owed. With the additional funding, we will be able to take a more proactive role in reaching out to taxpayers earlier in the collection process. We estimate that this will allow us to close an additional 244,000 collection cases. The funding also will provide additional staff to handle an increasing number of cases involving unpaid employment taxes, which we estimate will allow us to close an additional 45,000 employment tax cases. As a result, we project additional annual, direct enforcement revenue of \$617 million once new hires reach full potential in FY 2017, an ROI of \$8.5 to \$1.

Improve efforts in the tax-exempt sector: \$16 million. With this additional funding, the IRS will be able to continue its focused oversight of the tax-exempt sector and improve service to make voluntary compliance easier. We estimate these additional resources will allow us to reach our goal of cutting our backlog of 501(c)(3) applications in half and reducing the processing time for all applications to a period of two weeks or less for smaller organizations and no more than six months for all applications.

Pursue fraud referrals and tax schemes: \$18 million. This additional funding will be dedicated to improving our efforts in the core enforcement areas of corporate fraud, employment tax, and abusive tax schemes by increasing the number of convictions and assessments of unpaid tax. A portion of the funding will be for the use of computer software that will allow the IRS to apply so-called network analysis to detect corporate fraud and abuse. With this software tool, the IRS will be able to identify schemes by linking together multiple potentially fraudulent returns or information items. These efforts are expected to help us achieve a conviction rate in this area for FY 2015 of 92 percent.

Enhance return preparer compliance: \$17 million. This additional funding will allow the IRS to increase service and compliance activities in regard to tax return preparers. The IRS will be able to increase audits of preparers and increase monitoring and pursuit of preparers engaged in fraudulent activities, including those who prepare large numbers of returns involving EITC claims. We estimate we will be able to conduct 200 additional preparer visits and more than two dozen additional investigations into fraudulent activity.

Use technology to enhance criminal investigation: \$4 million. This additional funding will allow the IRS to automate the processing of evidence gathered by our criminal investigators by implementing a virtual digital evidence processing environment. This new system will allow for more secure and efficient evidence processing nationwide, and reduce travel by IRS agents and investigative specialists.

Use technology to improve audit case selection: \$37 million. This additional funding will enable the IRS to improve the way we gather and use electronic data, which will in turn allow us to do a better job of selecting cases for audit and focusing on issues that need to be examined. This is important because the IRS needs to continually adapt to changing taxpayer behavior to prevent tax fraud and abuse. Under the initiative we envision, we will significantly increase the digital availability of tax return information and then employ technology to analyze this information in order to better detect noncompliant taxpayer behavior.

Expand Virtual Service Delivery (VSD): \$8 million. This additional funding will create a secure, web-based digital communications channel through the Internet using online messaging that ultimately will allow the IRS to communicate directly with taxpayers while they are at work or at home, or using their mobile device. This will improve the taxpayer experience in resolving difficult issues with their accounts.

Enhance online services: \$16 million. With this additional funding, the IRS will develop additional digital applications that will further improve taxpayers' online interactions with the IRS. This technology investment will help provide secure digital communications, and add more interactive capabilities to existing web self-service and mobile products.

Implement ACA: \$452 million. This additional funding, the majority of which is for required information technology upgrades, will allow the IRS to increase efforts to ensure compliance with a number of tax-related provisions of the ACA, and also perform outreach and educational activities so that taxpayers will understand what these provisions require, as well as covering additional phone calls made by taxpayers inquiring about the ACA. The funding will also assist the IRS in continuing to implement a major ACA provision going into effect in 2014 –

the premium tax credit, which will help millions of Americans purchase affordable coverage.

Implement FATCA: \$32 million. With this additional funding, the IRS will invest in advanced technology to allow the agency to continue implementing FATCA, which in turn will provide more information to us on offshore accounts of U.S. citizens. As mentioned above, FATCA includes new reporting and withholding requirements for foreign financial institutions. To properly process and analyze the data we receive as a result of these new requirements, the IRS will need to build new technology systems and modify existing systems.

Enhance information technology services: \$10 million. This additional funding will enable the IRS to continue upgrading its computer systems, and in particular convert the agency's operating system to a less complex standard, which will decrease our need for computer hardware. These investments will result in a more stable computing environment and reduce delays in providing service to taxpayers.

Consolidate and revitalize IRS office space: \$10 million. With this additional funding, the IRS will be able to consolidate office space in Atlanta, GA, and design a new, modernized facility for processing tax returns at the IRS campus in Covington, KY. These activities, in turn, will allow the agency to improve efficiencies and achieve long-term savings.

Enhance IRS procurement and security systems: \$31 million. This additional funding will allow the IRS to improve the efficiency of our procurement processes and also improve security for our employees and our resources.

Improve IRS financial accounting systems: \$12 million. This additional funding will help the IRS ensure more timely and accurate reporting of data on the revenue we collect. The funding will also allow the IRS to make necessary system and programming changes to comply with various federal mandates, and to stay current with internal changes made to IRS' tax processing systems for tax administration that also affect financial reporting.

IV. CONCLUSION

Chairman Udall, Ranking Member Johanns and members of the Subcommittee, thank you again for the opportunity to update you on IRS operations and discuss the FY 2015 President's Budget request for the IRS. It is vital that we find a solution to our budget problem, so that the IRS can be on a path to a more stable and predictable level of funding. I look forward to working with Congress and this Committee to do just that. In order to ensure that the IRS can continue to deliver on its dual mission of providing quality taxpayer service and ensuring compliance with the nation's tax laws, I hope that one of the legacies of my term as IRS

Commissioner will be that we put the agency's funding on a more solid footing.
This concludes my statement, and I would be happy to take your questions.