

**WRITTEN TESTIMONY
OF
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INTERNAL REVENUE
BEFORE
THE HOUSE WAYS & MEANS
SUBCOMMITTEE ON OVERSIGHT
FILING SEASON AND FY 2013 BUDGET REQUEST
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INTRODUCTION AND SUMMARY

Chairman Boustany, Ranking Member Lewis and Members of the Subcommittee, thank you for this opportunity to testify on this year's tax filing season and to provide you with a quick look at some of our recent successes and an overview of our proposed FY 2013 Budget and what we hope to accomplish with these resources.

The 2012 filing season is underway and as of March 10, 2012, the IRS received over 70 million individual returns. The IRS has issued 59.2 million refunds for a total of \$174 billion, as compared to 59 million refunds for a total of \$178 billion over the same time period in 2011. The average dollar refund was approximately \$3,000, about the same as last year. During the same time period, the IRS directly deposited 51.3 million refunds to taxpayers, as compared to 49.8 million last year – a 3 percent increase.

The IRS E-file program continues to grow. This year the individual E-file rate continues to trend upward – a very positive development. Later in my testimony, I provide more statistics and information on the current filing season.

Let me turn to the FY 2103 Budget for the IRS. Although the economy is regaining strength, we still face numerous challenges, such as finding the right balance between fiscal discipline while still investing in programs that produce a high rate of return, and are important to the future of our nation and the American people.

It is incumbent upon all of us in government to be as efficient as possible and spend taxpayer dollars wisely. For the IRS, that means finding savings where we can, and continuing to invest in strategic priorities that allow us to improve service and voluntary compliance.

Indeed, the IRS consistently achieves a high return on investment for its activities while running a fiscally disciplined operation. From FY 2009 through the FY 2013 proposed budget, the IRS will have achieved nearly \$1 billion in budget savings and efficiencies. At the same time, the agency collected nearly \$200 in government revenues for every dollar spent on the IRS budget.

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 FY 2011, the IRS collected \$2.415 trillion in taxes, representing 92 percent of federal government receipts. The IRS processed more than 144.7 million individual returns during the 2011 filing season and issued almost 110 million refunds totaling \$345 billion that traditionally help boost consumer spending.

The IRS is proud of its record over the past few years as we have made tangible progress on a number of strategic initiatives while carrying out our core duties, such as delivering a smooth filing season in 2011 – in spite of the late passage of legislation. The following are some of the more prominent programs and initiatives, including those in our core programs that demonstrate how targeted investments can deliver real value to taxpayers and our nation.

Return Preparer Program

The Return Preparer Program is one of the most important initiatives the IRS has undertaken in recent memory that leverages preparers' expertise and commitment to quality service and the integrity of the tax system.

Boiled down to its essence, the program will ensure a basic level of competency for return preparers while enabling us to focus on finding unscrupulous preparers. First, we had to identify all preparers and have them register.

Since September 2010, almost 840,000 individuals have registered and obtained a Preparer Tax Identification Number, or PTIN, and are now in our tax professional database. And we are learning some interesting facts about not only the size, but the nature of the tax preparer community. For example, over 60 percent of PTIN holders are not attorneys, CPAs, or enrolled agents.

Once PTIN registration was in place, we began the next phase of the program aimed at ensuring a minimal level of competency for all return preparers.

In November 2011, we launched a new competency test for certain tax return preparers who prepare Form 1040 returns but who are not attorneys, CPAs, or enrolled agents, or supervised by one of them in a firm. These individuals also have a new requirement to complete 15 hours of continuing education each year from IRS approved providers.

Let me add also that from the beginning we planned to exempt CPAs, attorneys, and enrolled agents from the testing and continuing education requirements as they already have more stringent testing and education requirements.

As we've set up the registration, testing and continuing education components of our return preparer initiative, it is also important that we focus on finding unscrupulous preparers who damage the good name of honest return preparers and undermine the

overall tax system; therefore, we have a comprehensive strategy to focus on preparer enforcement and compliance.

Our compliance efforts will be focused on places of highest risk – where the vast majority of preparers who play by the rules should want us to focus.

We will also continue to conduct undercover shopping visits to return preparers suspected of engaging in fraud, and we will continue to work closely with the Department of Justice to pursue civil or criminal action against unscrupulous return preparers.

Customer Account Data Engine 2 (CADE 2) Launch

In January 2012, the IRS for the first time since the beginning of automated processing of tax returns five decades ago began processing tax returns daily instead of weekly. The new system, known as CADE 2, is a major milestone for the tax system and the IRS.

CADE 2 addresses myriad issues that have historically created issues in the tax system. It will provide more up-to-date information at the fingertips of our customer account representatives, speed account issue resolution, allow for faster refunds, and provide a platform for more real-time analytics and compliance. It will also eliminate structural technology problems that could lead to time-lag problems, such as when notices are sent to taxpayers.

For example, it will enable faster resolution of taxpayer account issues and account adjustments, which will greatly help taxpayers and the IRS. And it will correct one of the biggest problems we have when a taxpayer calls about a payment he or she made, but our representative cannot tell whether it has been posted or not.

Taxpayers and practitioners will also see quicker updates to web-based applications, and faster taxpayer notices. The CADE 2 database will also allow IRS to consider offering a wider range of web-based, self-initiated service solutions that could fundamentally change the way taxpayers interact with the IRS, and potentially provide greater operational efficiencies.

CADE 2 also supports sophisticated, next-generation compliance systems which will improve overall compliance through enhanced workload selection and by enabling advanced decision analytics.

Budget Trends

Over the last several years, the IRS budget requests have reflected strategic investments in the IRS that serve to reduce the deficit, along with substantial efficiency and other targeted reductions that reflect our commitment to effective stewardship of the resources that we are given.

These savings and efficiencies reflect an across-the-board commitment to finding better and more efficient ways to administer the tax system. They come from a variety of sources, including reductions in outside contracts, training and all but case-related travel.

However, even with these efficiencies, the IRS would not have been able to meet the level of budget reduction enacted for FY 2012 without substantially reducing our headcount. The IRS had already instituted an agency-wide hiring freeze and has only been replacing attrition on an exception basis. Attrition savings were not sufficient to meet the 2012 levels, though, so the IRS resorted to voluntary incentives designed to accelerate retirements of those who were retirement-eligible, or close to eligible. As of March 5, 2012, these incentives – known as buyouts – were given to approximately 1,000 workers.

As a result of these measures, the IRS has approximately 5,000 fewer staff on the payroll this filing season, as compared to last year. Of the 5,000 person reduction, approximately 3,000 are in Enforcement, with the balance of the reduction principally coming from Taxpayer Service.

Offshore Tax Evasion

Our approach to offshore tax evasion follows the natural course of cleaning up the abuses of the past and then mining and leveraging the data we receive to mount a greater attack on the abuse.

A good example of our offshore successes is the IRS' work relating to a major Swiss bank, where for the first time in history, a bank secrecy jurisdiction turned over thousands of names and account numbers. The bank also agreed to pay hundreds of millions of dollars in fines, penalties, interest and restitution as part of a deferred prosecution agreement with the U.S. government.

However, our offshore work has never been about one bank or one country. The IRS has produced results and will continue to produce positive outcomes through other elements of our offshore program, such as our game-changing voluntary disclosure programs.

In January 2012, we reopened the Offshore Voluntary Disclosure Program (OVDP) to help people hiding offshore accounts get current with their taxes; as of the end of 2011, we had collected more than \$4.4 billion to date from the two previous OVD programs in 2009 and 2011. That number will grow as the IRS processes the 2011 cases.

Our decision to reopen the OVDP was a result of continued strong interest from taxpayers and tax practitioners after the closure of the previous programs. People still wanted to come in and get right with their government.

This new program makes good sense for taxpayers still hiding assets overseas and for the nation's tax system. This is the best chance to get these taxpayers back into the system and back into compliance, so they properly report and pay their taxes for years to come.

Large Business Issue Resolution

We have been in the process of transforming our relationship with our large corporate taxpayers. We need to work smarter. We need to be more efficient. We need to create innovative strategies for issue resolution that are less time and resource intensive for both the IRS and these taxpayers.

We now have a suite of programs at the IRS that are designed to provide greater certainty, consistency and efficiency going forward for both our large taxpayers and the IRS. They may have different names and functions but all are focused on resolving issues.

First is the Compliance Assurance Program (CAP), which we made permanent last year. Any corporation that meets the program's requirements and wants to enjoy the benefits of open, cooperative, and transparent interactions can now apply. The number of corporate taxpayers in the program has already grown from 17 in the 2005 tax year – when the pilot began – to 160 taxpayers in the 2011 tax year. In recent months, I've been talking with CAP taxpayers, and the feedback I've gotten is that the paradigm of transparency and certainty is a welcome change in our tax system.

We have another important tool in our toolkit that can help us cut through the fog of uncertainty. The Industry Issue Resolution Program (IIR) can help the IRS and corporate taxpayers reach administrable, common sense solutions for uncertain tax areas. For example, by using IIR, we resolved some long-standing controversies that had plagued the telecommunications, transmission and distribution industries for years. We see IIR as a very useful tool for issue resolution and continue to work on a number of new issues.

Fast Track Settlement is an additional issues resolution tool we are encouraging our agents to use. Instead of finishing an audit and then going to Appeals, Fast Track allows a taxpayer to settle an issue with an Appeals officer during the audit process. We have witnessed an uptick in participation, which is promising, and are committed to expanding our ability to resolve issues more quickly with taxpayers who want to do so. The latest data is also most promising. It shows that 83 percent of the cases accepted into Fast Track resulted in a resolution.

Our uncertain tax position (UTP) initiative gets to the heart of information we need, while respecting a taxpayer's internal analysis and deliberations. The program's goal is to have a transparent discussion with corporations to resolve issues much quicker, and be more efficient in targeting taxpayers and issues with the highest risk of non-compliance. And here are the latest statistics on Schedule UTP. As of January 1, 2012:

- Approximately 1,900 taxpayers have filed Schedule UTP
- Approximately 4,000 issues have been disclosed

- The top three Code sections are Section 41, research tax credits; Section 482, allocation of income including transfer pricing; and Section 162, trade or business expenses
- 19 percent of all issues disclosed are transfer pricing issues.

Lastly, I am the Chair of the global body of tax authorities called the Forum on Tax Administration (FTA). We have been very focused on governments moving from information sharing to real, coordinated action. To that end, the U.S. recently led an effort to develop a protocol for joint audits, where two or more countries conduct a single audit of a taxpayer. At the same time we were developing a protocol for joint audits through the FTA, I asked our IRS team to find opportunities to start some joint audits immediately.

We recently conducted a joint audit involving one of our CAP taxpayers on a transfer pricing issue that demonstrated the substantial benefits for both governments and taxpayers. The joint audit reduced taxpayer burden – especially for these large multinational corporations that must face audits in multiple jurisdictions on the same set of transactions. It provided the taxpayers with a timesaving and less resource-intensive way to address the tax consequences of a transaction on a bilateral or even multilateral basis. And just as important to a swift resolution of issues, the joint audit provided certainty for the taxpayer today and in the future.

We at the IRS have dedicated ourselves to creating innovative new paths that will help both businesses and the IRS resolve issues and achieve our shared goals of certainty, consistency and efficiency. I think we can all agree that these are goals that, if achieved, would benefit the entire tax system.

IRS Customer Service

The IRS continues to provide taxpayers with quality customer service and different service channels and products. We recognize that we must never stop innovating to meet the service needs of an increasingly diverse taxpayer base and must serve taxpayers when and where they need it.

Our broad portfolio of customer service channels 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 and web-based applications and social media. All make it easier for taxpayers to file and pay their taxes.

One of our most far reaching innovations – and one of the most successful modernization programs in all of government – is e-filing. For the 2011 calendar year, the IRS processed more than 110 million individual tax returns electronically, setting a new record. Individual returns electronically filed increased to 77.2 percent, up 7.9 percent from 2010. Business returns filed electronically jumped to 33.9 percent, up from 26.6 percent in 2010 and home-computer filing increased to 39.8 million returns, 14.2 percent more than 2010.

IRS.gov has become the favorite source of information for millions of taxpayers. For the 2011 filing season, there were almost 323 million web page visits to IRS.gov – a five percent increase over the same time period last year. Use of the “Where’s My Refund” electronic tracking tool continued to post double-digit yearly gains. And in FY 2011, the IRS received a Compuware Gomez “Best of the Web” award, which recognized IRS.gov as one of the best websites in government for performance and quality and first in consistency.

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. Last year, 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 application reflects our commitment to modernizing the agency and engaging taxpayers where and when they want.

However, we have not forgotten the importance of the content of our communications and we launched a major plan to overhaul our notices with a focus on clarity. Our efforts were recognized last May when the Center for Plain Language honored the IRS with the ClearMark Grand Prize Award, citing two of our revised notices for the best clear language of all the documents they reviewed.

We received another important sign of the progress the IRS is making: every year, the American Customer Satisfaction Index survey is conducted and for 2011, the survey of taxpayers showed satisfaction with our services reaching 73 on a scale of 100 among all individual tax filers. That score is a three-point jump from a year earlier and our highest score since we began participating in the survey that began in 1994. Satisfaction among people who filed electronically came in even higher at 78. This is a tremendous step in the right direction and one that we will build upon in the future.

Enforcement

Turning to enforcement, 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. As previously noted, through our Offshore Voluntary Disclosure Programs we have collected more than \$4.4 billion to date from those hiding money overseas and that number will grow as the IRS processes the 2011 cases.

In FY 2011, IRS compliance activities returned \$55.2 billion to the Treasury as a result of our examination and collection programs. While the direct revenues brought in by IRS activities are important, the indirect effects are far more substantial and important. A strong and fair enforcement program serves to support over \$2 trillion that is paid voluntarily and on a timely basis every year. In addition, IRS enforcement revenues do

not include billions of dollars in attempted refund fraud that is stopped by IRS upfront fraud detection programs.

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

People

The IRS' workforce is our greatest asset. Three years ago, I embarked on a campaign to make the IRS the best place to work in the federal government. This past November, the Partnership for Public Service released the results of the 2011 Best Places to Work in Federal Government survey. The IRS ranking improved yet again, moving over a two-year period from a ranking of 127 to a ranking of 65 out of the 240 participating agencies. And, we are now ranked third out of 15 large agencies (those with over 20,000 employees) in the employee engagement index from the survey.

In addition, our own employee engagement index – which measures the degree of employees' motivation, commitment and involvement in the mission of the organization – and the job satisfaction index both remained stable compared with last year. In other words, we saw no erosion of the substantial gains we had made over the past few years.

This is especially heartening to me because we have faced more than the usual number of challenges this year, from late tax law changes, to six short-term continuing resolutions during filing season, to weeks of speculation of a possible government shutdown, and ultimately a decreased budget.

The fact that our survey results showed that our employees remain engaged, motivated and committed, regardless of the external environment, is a testament to the professionalism and deep commitment to service woven into the culture of the IRS.

Real-Time Tax System

Last April, I began discussing a potential new structure that would fundamentally change the way taxpayers and tax practitioners prepare and file individual returns and that leverages technological innovations.

We initially came to call this vision the “real-time” tax system because it would deal in real time. We want to move away from the after-the-fact or “look-back” model where audits may take place years after a return is filed, and taxpayers had to hunt for, or recreate records and documentation – to a new model where we reduce burden.

Under the vision of a real-time tax system, the IRS could embed more information return data into its pre-screening filters, and could provide the opportunity for taxpayers to fix the return before we accept it – if it contains data that does not match our records.

Under this vision – which I’ve described as a long-term destination, rather than a short-term project or initiative – taxpayers and the IRS would have more confidence that returns are accurate. Many problems could be dealt with up-front, while records are available, and many taxpayers have access to the tax professional who may have prepared their return. We could shift resources to spend more money on getting it right in the first place, and focus back-end auditing resources on more complex issues. There are huge compliance and service benefits associated with such a system, not to mention burden reduction for taxpayers.

The IRS has held two public meeting to get feedback on our initial work on real-time. Both of these meetings were very helpful to us and reinforced our belief that this is a vision worth pursuing.

THE 2012 FILING SEASON & TAXPAYER SERVICE

Mr. Chairman, there is much of which to be proud this filing season. Let me stress that providing quality taxpayer service throughout the year, but especially during the filing season, is important if we are to help taxpayers get it right from the start and avoid making unintentional errors. Assisting taxpayers with their questions before they file their returns prevents inadvertent noncompliance and reduces burdensome post-filing notices and other interactions with the IRS.

Submission Processing, Refunds and E-filing

As of March 10, 2012, the IRS received over 70.7 million individual returns. Overall individual filing is up near five percent compared to the same time period last year.

The IRS e-file program continues to grow. This year the individual e-file rate is trending higher than last year – a very positive development. On the other hand, paper returns are dropping.

The number of taxpayers e-filing their returns themselves continued to grow this filing season. As of March 10, 2012, more than 25.6 million prepared their own e-file return – an 11 percent point increase over the same time period last year. The overall growth in e-filing translates into a huge savings for the Federal Government.

For FY 2010, it cost only 17 cents to process an e-filed return – a fraction of the \$3.66 it takes to process a paper return. And with e-file, taxpayers get their refund faster, with fewer data processing errors that can lead to problems later in the process.

Indeed, taxpayers filing electronically can get their refunds as soon as 10 to 21 days upon acknowledgement of receipt by the IRS. Based on the most current Refund Timeliness data, the average time to process a refund for a paper tax return is six weeks upon receipt of the return.

Through March 10, 2012, the IRS issued 59.2 million refunds for a total of \$174.4 billion, as compared to 59 million refunds for a total of \$178.3 billion over the same time period in 2011. The average dollar refund was approximately \$3,000, about the same as last year. During the same time period, the IRS directly deposited 46.2 million refunds to taxpayers, as compared to 45.3 million last year – a two percent increase.

I would be remiss if I did not acknowledge that in the first few weeks of the tax filing season, we experienced some delays in processing a subset of e-filed returns. These were temporary issues that affected a subset of taxpayers who filed in late January and early February, and the issues were resolved by mid-February. And, even with the delays, the IRS was generally delivering refunds in our normal 10 to 21 day time frame. I recognize that this group of taxpayers encountered delays this filing season and we regret the inconveniences caused.

Even with these initial issues, the overall average refund timeline remained steady in FY 2012 when compared to FY 2011. In other words, the delays were isolated to early issues in the filing season, and after that IRS was processing tax returns according to normal refund timelines.

Toll-Free Telephone Performance

High quality toll-free telephone service – both assistor and automated – is an extremely important tool in answering taxpayer questions, helping them navigate an extremely complex tax code and making voluntary compliance easier.

As of March 3, 2012, IRS telephone assistors answered 7.3 million calls. The IRS also completed 29.5 million automated calls – a 45.5 percent increase over last year’s 20.3 million calls, reflecting a growing taxpayer appetite for quality self-serve options.

Accuracy rates for both customer tax law and account questions remain in the 90-plus percentile with minimal change over last filing season’s levels.

Website Usage and New Media

IRS.gov continues to be the favorite source of information for millions of taxpayers. As of March 3, 2012, there were over 157 million visits to IRS.gov – a 35 percent increase over the same time period last year. Use of the “Where’s My Refund” electronic tracking tool continued to post double-digit yearly gains. IRS.gov/Español offers many of the same services and information in Spanish.

Taxpayers can also use electronic tools, such as the Earned Income Tax Credit (EITC) Assistant, to determine if they qualify for the refundable tax credit or a withholding calculator to help them determine the right amount of tax to withhold from their paychecks.

The Interactive Tax Assistant (ITA) is an expanded resource this filing season that provides consistent answers to a limited number of tax law questions using a probe and response process. The ITA will guide you to accurate answers that are not readily addressed through simple Frequently Asked Questions.

As previously noted, the IRS is increasingly employing social and new media to reach taxpayers who do not get their information from traditional sources. For example, during the week of February 10-17, 2012, our YouTube Video “When Will I Get My Refund?” had more than 254,000 views. Our “tweet” and subsequent “re-tweets” on the “Dirty Dozen” tax schemes reached almost 28,000 people. The IRS Video in English is currently the 4th most viewed Federal Government YouTube channel with nearly three million total views.

Taxpayer Assistance Centers (TACs)

As of March 3, 2012, approximately 1.16 million taxpayers were served at TACs – a nearly five percent decrease over the previous year. In addition to IRS help, community organizations partner with the IRS. Volunteer Income Tax Assistance programs assist people who earned \$50,000 or less, and Tax Counseling for the Elderly programs assist individuals age 60 and over with their 2012 income tax return preparation and electronic filing. Many of these sites have Saturday hours while others offer assistance at various times during the week.

Limited English Proficiency (LEP)

Today, the IRS offers language services to LEP taxpayers, thereby affording them the same access to Federal benefits and services as English speakers. We now have more than 2,300 bilingual employees who provide services to LEP taxpayers; a Spanish language web site; and a Multilingual Gateway that provides information in Chinese, Vietnamese, Korean and Russian. A telephone interpreter service is also available in more than 170 languages, and more than 600 tax products have been translated into languages such as Spanish, Chinese, Vietnamese, Russian and Korean.

Identity Theft

Mr. Chairman, I know that the Committee staff has been working closely with IRS staff. I would simply like to reiterate that the IRS is intently focused on executing a two-pronged identity theft strategy that focuses on both fraud prevention and victim assistance. We continue to improve our programs to prevent and detect identity theft and although we cannot stop all identity theft, we are working hard to resolve issues created when identity theft occurs. And in calendar year 2011, the IRS protected \$1.4 billion in refunds from being erroneously sent to identity thieves.

Finally, working closely with the Justice Department, IRS criminal investigators are pursuing those who are behind these schemes. In January, the IRS and Justice

Department announced a nationwide sweep that targeted 105 people in 23 states, and our efforts in this area continue.

THE ADMINISTRATION'S FY 2013 BUDGET REQUEST FUNDS KEY PRIORITIES

The Administration's Fiscal Year 2013 Budget request for the Internal Revenue Service is approximately \$12.8 billion, a \$944.5 million increase (8%) over the FY 2012 enacted level but only a \$639.3 million increase (5.3%) from the level enacted for FY 2011. A significant portion of the increase from FY 2012 represents the Administration's request to restore lost resources resulting from reductions in IRS funding made over the past two years. This request is designed to provide the resources necessary to administer and enforce the current tax code, implement recent changes to the law to update the Code and serve the American taxpayer in a timely manner.

To collect the revenues required to fund the policies passed by Congress and meet long-term obligations to the American people, the IRS FY 2013 funding request reflects a continued commitment to improving tax compliance through the balance of quality taxpayer service with fair enforcement of the tax laws. It also supports the Administration's strategic goal of managing the government's finances in a fiscally responsible manner.

As noted in the introduction to my testimony, the IRS consistently achieves a high return on investment for its activities while running a fiscally disciplined operation. In FY 2013, the IRS expects to identify nearly \$71 million in cost savings from increased use of electronic return filing, reductions in non-case related travel and streamlining operations.

Enforcement Program

The FY 2013 Budget request includes \$403 million in new IRS enforcement activities, which are expected to raise \$1.48 billion in revenue annually at full performance, once new hires are fully trained and develop broader experience by FY 2015. The return on investment is 4.3-to-1. The return on investment is even greater when factoring in the deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact.

The enforcement budget also includes \$200 million in additional examination and collection programs that will generate more than \$1.1 billion in additional annual enforcement revenue by FY 2015. Investments such as these in IRS enforcement programs are especially important to further the IRS' mission of improving tax compliance.

Specific areas where the proposed FY 2013 funding will enable the IRS to continue to strengthen enforcement efforts and reduce the tax gap include:

- Improving international compliance by individual and business taxpayers. In FY 2013, the IRS will continue to address offshore tax evasion by individuals through such efforts as increased examinations and the special offshore voluntary disclosure program. To ensure business entity compliance, the IRS will provide additional international technical specialists to increase coverage of complex international transactions;
- Protecting revenue by expanding efforts to identify fraud and prevent issuance of questionable refunds, including tax-related identity theft. The increase in funding will help support efforts to reduce erroneous refund payments, including non-compliant and fraudulent claims by prisoners and claims for the EITC by ineligible taxpayers;
- Implementing tax law changes that make available the use of new information reporting requirements to help address the underreporting tax gap; and
- Enhancing IRS oversight of complex financial situations, including transfer pricing and uncertain tax positions.

Return Preparer Initiative

The FY 2013 Budget request includes \$35 million to strengthen return preparer compliance. It bears repeating that this initiative is one of the most important that the IRS has undertaken in recent years, the foundation of which is mandatory registration for all paid tax return preparers. In addition, the IRS is developing requirements to establish mandatory competency testing and continuing education for preparers to ensure that taxpayers are hiring preparers who have a minimum level of competency and adhere to professional standards. This initiative is core to the IRS' tax gap strategy and will increase government revenue, and support high-priority, preparer-related enforcement activities.

Implementation of Tax Law Changes

The request provides \$128 million to support IRS efforts to implement programs that are designed to ensure compliance with a number of recent changes to the tax laws, and to help taxpayers understand them. Recent tax law changes include the reporting provisions related to merchant payment cards and third party reimbursements (included in the Housing and Economic Recovery Act of 2008), basis reporting on securities sales (included in the Emergency Economic Stabilization Act of 2008), and the non-exchange related tax law changes included in the Affordable Care Act (ACA).

Infrastructure Requirements

The FY 2013 Budget also requests funding for the IRS to continue the development of new information technology systems, and substantial modification and enhancement of

existing systems necessary to implement the new premium assistance tax credit and other tax law provisions related to the insurance exchanges created in the ACA.

Taxpayer Service Program

The FY 2013 request provides funding for the IRS to continue delivering services using a variety of in-person, telephone and web-based channels to help taxpayers understand their tax obligations, correctly file their returns and pay taxes due in a timely manner.

The IRS is committed to expanding the use of electronic transactions, including increasing the e-file rate and expanding taxpayer service options available over the Internet. In 2011, there were more than 322 million visits to IRS.gov, and more than 78 million taxpayers checked their refund status by accessing Where's My Refund? in English or in Spanish on our website.

Business Systems Modernization

In FY 2013 the IRS will continue the modernization of its IT systems. It will strategically invest in state-of-the-art capabilities, such as online taxpayer services, and focus on the second phase of the CADE 2, to ensure the long-term viability of IRS tax processing systems.

In 2012, the IRS delivered the most significant update to its core tax processing system in decades. As noted, through the deployment of the first phase of CADE 2, the IRS transitioned to a daily processing cycle from a weekly batch cycle. Also for the first time, IRS processing systems began accepting all 1040 forms electronically through a modernized e-filing capability.

EXPLANATION OF BUDGET ACTIVITIES

Taxpayer Services

The FY 2013 President's Budget request is \$2,253,133,000 in direct appropriations, an estimated \$24,050,000 from reimbursable programs, and an estimated \$142,742,000 from user fees, for a total operating level of \$2,419,925,000. This appropriation funds the following budget activities.

Pre-filing Taxpayer Assistance & Education (\$625,931,000 from direct appropriations, \$1,151,000 from reimbursable resources)

This budget activity funds services to assist with tax return preparation, including tax law interpretation, publication, production, and advocate services. In addition, funding for these programs continues to emphasize taxpayer education, outreach, increased volunteer support time and locations, and enhancing pre-filing taxpayer support through electronic media.

Filing & Account Services (\$1,627,202,000 from direct appropriations, \$22,899,000 from reimbursable resources, and an estimated \$142,742,000 from user fees)

This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically-submitted tax returns, issue refunds, and maintain taxpayer accounts. The IRS continues to make progress in decreasing paper returns and increasing the use of electronic filing and payment methods. This budget activity also provides operating resources to administer the advance payment feature of the Trade Act of 2002 (Public Law 107-210) health insurance tax credit program, which assists dislocated workers with their health insurance premiums.

Enforcement

The FY 2013 President's Budget request is \$5,701,670,000 in direct appropriations and an estimated \$73,604,000 from reimbursable programs, and an estimated \$17,750,000 from user fees, for a total operating level of \$5,793,024,000. The total direct appropriations level includes an additional appropriation for tax enforcement and compliance activities funded through a program integrity cap adjustment totaling \$691,028,000, of which \$276,964,000 will be funded from the Enforcement account. This appropriation funds the following budget activities.

Investigation (\$688,296,000 from direct appropriations, and an estimated \$61,633,000 from reimbursable resources) This budget activity funds the criminal investigations programs that uncover criminal violations of the internal revenue tax laws and other financial crimes, enforce criminal statutes relating to these violations, and recommend prosecution as warranted. These programs identify and document the movement of both legal and illegal sources of income to identify and document cases of suspected intent to defraud. It provides resources for international investigations involving U.S. citizens residing abroad, non-resident aliens and expatriates and includes investigation and prosecution of tax and money-laundering violations associated with narcotics organizations.

Exam & Collections (\$4,846,749,000 from direct appropriations, and an estimated \$11,307,000 from reimbursable resources) This budget activity funds programs that enforce the tax laws and increase compliance through examination and collection programs that ensure proper payment and tax reporting. It includes programs such as specialty program examinations (employment tax, excise tax and estate and gift exams), and international collections and examinations. The budget activity also supports appeals and litigation activities associated with exam and collection.

Regulatory (\$166,625,000 from direct appropriations, an estimated \$664,000 from reimbursable resources, and an estimated \$17,750,000 from user fees)

This budget activity funds the development and printing of published IRS guidance materials; interpretation of tax laws; internal advice to the IRS on general non-tax legal issues such as procurement, personnel, and labor relations; enforcement of regulatory rules, laws, and approved business practices; and support of taxpayers in the areas of pre-filing agreements, determination letters, and advance pricing agreements. The Return

Preparer initiative is funded within this activity in addition to the Office of Professional Responsibility which is responsible for identifying, communicating, and enforcing the Treasury Circular 230 standards of competence, integrity, and conduct of professionals representing taxpayers before the IRS.

Operations Support

The FY 2013 President's Budget request is \$4,476,200,000 in direct appropriations, an estimated \$37,564,000 from reimbursable programs, and an estimated \$57,958,000 from user fees, for a total operating level of \$4,571,722,000. The direct appropriations level includes an additional appropriation for tax enforcement and compliance activities funded through a program integrity cap adjustment totaling \$691,028,000, of which \$414,064,000 will be funded from the Operations Support account. This appropriation funds the following budget activities.

Infrastructure (\$987,730,000 from direct appropriations, an estimated \$889,000 from reimbursable resources, and an estimated \$21,867,000 from user fees)

This budget activity funds administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-IT equipment.

Shared Services & Support (\$1,348,363,000 from direct appropriations, an estimated \$20,207,000 from reimbursable resources, and an estimated \$11,700,000 from user fees)

This budget activity funds policy management, IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equity, diversity and inclusion programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurement, and specific employee benefits programs.

Information Services (\$2,140,107,000 from direct appropriations, an estimated \$16,468,000 from reimbursable resources, and an estimated \$24,391,000 from user fees)

This budget activity funds staffing, equipment, and related costs to manage, maintain and operate the information systems critical to the support of tax administration programs. This includes the design and operation of security controls and disaster recovery planning. This budget activity funds the development and maintenance of the millions of lines of programming code that support all aspects and phases of tax processing and the operation and administration of the mainframes, servers, personal computers, networks, and a variety of management information systems.

Business Systems Modernization

The FY 2013 President's Budget request is \$330,210,000 in direct appropriations. This appropriation funds the following budget activity.

Business Systems Modernization (\$330,210,000 from direct appropriations)

This budget activity funds the planning and capital asset acquisition of information technology to continue the modernization of IT systems, including labor and related

contractual costs. In FY 2013, the IRS will strategically invest in state-of-the-art capabilities, such as online taxpayer services and focus on the second phase of the core taxpayer account database, CADE 2, Transition State 2, to ensure the long-term viability of IRS tax processing systems.

LEGISLATIVE PROPOSALS

The President's FY 2013 Budget request includes a number of legislative proposals intended to improve tax compliance with minimal taxpayer burden. These proposals will target the tax gap and generate more than \$12 billion over the next ten years. The IRS estimates the implementation cost for the proposals to be \$80.2 million over three years, including the initial startup, processing and compliance operational costs.

The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties. The Budget also proposes to amend the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA), as amended by the Budget Control Act (BCA) of 2011, to allow adjustments to the nine-year (FYs 2013-2021) discretionary caps to permit program integrity cap adjustments in support of additional IRS investments.

CONCLUSION

In conclusion, let me thank the subcommittee again for this opportunity to discuss the 2012 filing season and IRS Budget Request for FY 2013. Both reflect the progress and improvements the IRS continues to make – even in a difficult budget environment. Through its balanced and targeted investments in key enforcement, service and business modernization programs and initiatives, this budget will ensure that the IRS will continue its vital role in keeping our nation and economy healthy and strong.