

**WRITTEN TESTIMONY OF
STEVEN T. MILLER
ACTING COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
ON IRS OPERATIONS AND THE 2013 FILING SEASON
APRIL 25, 2013**

INTRODUCTION

Chairman Boustany, Ranking member Lewis, and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss this year's tax filing season and provide you with an overview of our proposed Fiscal Year 2014 Budget and what we hope to accomplish with those resources.

The 2013 filing season started with difficult challenges for the IRS. As the Subcommittee is aware, substantial tax law changes were enacted on January 2 of this year, just before the IRS would normally begin accepting e-filed returns. IRS staff worked nonstop, around the clock, to make changes to systems and forms necessary to open the tax filing season. I am pleased to say that, as a result of exceptional planning and hard work by our employees, all but a discrete minority of taxpayers were able to begin filing in late January, and all were able to file by early March.

Despite the challenges we faced at the outset, the filing season ran smoothly. Refunds went out quickly to taxpayers, and our strengthened refund fraud detection tools have been working well. As for customer service, accuracy rates for both customer tax law and accounts questions remain in the 90-plus percentile.

A more detailed description of the filing season can be found later in the testimony.

Let me turn to the FY 2014 Budget request for the IRS. This request was crafted during a time of fiscal austerity and belt tightening. The IRS remains committed to being as efficient as possible and spending taxpayer dollars wisely. We will continue to find savings wherever we can, while investing in strategic priorities that allow us to fulfill our dual mission of strong enforcement of the tax laws and excellent customer service. The IRS consistently achieves a high return on investment for its activities while running a fiscally disciplined operation.

The IRS is vital to the functioning of government and keeping our nation and economy strong. In FY 2012, the IRS collected \$2.524 trillion in gross revenue to fund the federal government, approximately 92 percent of all federal receipts. Moreover, for FY 2012, we processed more than 147.6 million individual tax returns and issued more than 121.6 million refunds to individual taxpayers totaling \$333 billion.

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

It is important to understand that the accomplishments outlined below may not be sustainable within the current budget environment. We will continue to attempt to maintain our excellence, but our performance could begin to reflect the impact of the budget cuts of the last few years. This does not mean there will be a catastrophic event or failure at the IRS; however, there could be a steady erosion in the service we provide to taxpayers and in the amount of money we collect through enforcement activities. We will continue to find efficiencies, and you will see that we have been aggressive in recent years in this regard. We will continue to dedicate staff and resources to the most essential uses and in the most critical areas. For example, we will continue to commit staff to resolving identity theft cases, even at the cost of having fewer people on our toll-free taxpayer service line or on our automated collection phones that help us collect past due taxes.

A Record of Success

Let me outline what we have accomplished. The IRS is proud of its record over the last several years. We have delivered smooth filing seasons and successfully carried out other core duties while also making important progress on a number of strategic initiatives. These initiatives include: cracking down on international tax evasion; fighting all refund fraud, but especially that related to identity theft; improving return preparer compliance; leveraging data analytics in order to improve our operations; modernizing our technology to benefit both taxpayer service and compliance; and positioning our workforce to ensure the IRS is prepared for tomorrow's challenges.

In the last few months alone we have had several signs that we are achieving success in some of the initiatives I mentioned above.

On the technology front, the Government Accountability Office (GAO) in February removed the IRS Business Systems Modernization program from its High-Risk list, where it had been since 1995. Citing the work the IRS has done to bolster information technology and financial management capabilities, the GAO concluded that the IRS had made substantial progress in addressing weaknesses over the past several years and had demonstrated a commitment to sustained progress. The GAO singled out delivery of the initial phase of the Customer Account Data Engine (CADE2), which has enhanced tax administration and improved taxpayer service.

In March 2013, the Excellence.gov Awards Program sponsored by the American Council for Technology and the Industry Advisory Council recognized CADE2 for Excellence in Enterprise Efficiencies. This awards program honors government programs and projects that use information technology in innovative ways to enhance government operations, provide a more open and transparent government, and deliver important citizen resources.

IRS is also maintaining quality on the customer service front. Every year, an independent survey is conducted by the American Customer Satisfaction Index (ACSI). For 2012, the survey of taxpayers who were satisfied with IRS services reached 75 on a scale of 100, up from 73 in 2011, and our highest score since 1994 when we began participating in the survey.

The following are some of the more prominent IRS programs and initiatives conducted during FY 2012, including those within our core programs, which demonstrate how targeted investments continue to deliver real value to taxpayers and our nation.

Enforcement

Enforcement of the tax laws is an integral part of the IRS' effort to enhance voluntary compliance. IRS enforcement activities, such as examination and collection, remain a high priority. In FY 2012, collections related to all enforcement activities exceeded \$50 billion for the third consecutive year. The IRS has shown significant progress in several key enforcement programs. Importantly, we also were able to hold individual audit rates above 1% during a period of scarce resources, and we increased criminal investigations by 5.1 percent, to 4,937.

International Tax Compliance

In FY 2012, the IRS enhanced international tax compliance efforts through the implementation of new legislation and through programs such as the Offshore Voluntary Disclosure Program (OVDP). In January 2012, the IRS reopened the OVDP with tightened eligibility requirements in response to strong interest from taxpayers and tax practitioners. Through the end of FY 2012, the OVDP has resulted in a total of more than 38,000 disclosures of unpaid taxes and collected more than \$5 billion in back taxes, interest and penalties.

Also during FY 2012, the IRS worked closely with businesses and foreign governments in implementing FATCA. This legislation strengthens offshore compliance efforts by requiring all foreign financial institutions with U.S. accounts to report detailed information about foreign account holders to the IRS or face a 30-percent withholding tax. The Administration's FY 2014 Budget request allows for more work in this area, and in particular funds our work on FATCA's new offshore account reporting rules.

Tax Return Preparer Program

The IRS continued implementation of its Return Preparer Program, begun in FY 2011. The foundation of this program is mandatory registration for all paid tax return preparers. Through September 2012, more than 860,000 preparers have requested Preparer Tax Identification Numbers (PTINs) using the online registration system.

In February 2013, a federal court stopped the IRS from enforcing the competency testing and continuing education requirements for registered return preparers. The injunction does not apply to the requirement to obtain a PTIN, so that portion of the program continues. But at this time we are not permitted to move forward with testing or continuing education requirements. We remain confident in our legal authority and remain committed to protecting taxpayers through implementing reasonable standards in this area. The original district court opinion is under appeal.

The PTIN registration requirement provides an important and improved view of the return preparer community from which the IRS can leverage information to improve communications, analyze trends, spot issues and detect potential fraud. And we are developing new approaches in this area. For example, one pilot we conducted in 2012 used real-time data to assess the fraud risk associated with Earned Income Tax Credit (EITC) return preparers and test the effectiveness of alternative compliance treatments. This pilot involved 1,500 preparers who filed large numbers of returns claiming the EITC. Taken together, the various compliance treatments we used in the pilot resulted in a total savings on improperly claimed tax credits – including the EITC and the Child Tax Credit – of approximately \$200 million. We continue to develop new approaches in this area.

Refund Fraud and Identity Theft

Our efforts to address identity theft and refund fraud are expanding and touch nearly every part of the IRS. We are working hard to prevent fraud, investigate identity theft-related crimes and help taxpayers who have been victimized by identity thieves. Over 3,000 IRS employees are currently working on identity theft – more than double the number at the start of last filing season. We have also trained 37,000 employees who work with taxpayers to recognize identity theft and help victims. Since the beginning of 2013, the IRS has worked with taxpayers victimized by identity theft to resolve and close more than 200,000 cases. To help past identity theft victims avoid delays in filing future returns and receiving refunds, we expanded the issuance of Identity Protection Personal Identification Numbers to more than 770,000 past victims this year, more than twice as many as last year.

Last fiscal year, the IRS significantly expanded its fraud detection efforts, expending nearly \$330 million combating refund fraud, including identity theft. During FY 2012, the IRS protected more than \$20 billion of revenue related to fraudulent returns, including identity theft, up from \$14 billion in the prior year. IRS efforts stopped 5 million suspicious returns in 2012 – up from 3 million stopped in 2011.

So far this filing season, the IRS has suspended or rejected over 2 million suspicious returns. Over 400,000 of these were rejected at the point of filing before they even entered IRS processing systems. The remaining returns generally require further review to determine whether the filer is legitimate. Because these returns require time to review, most are still in open inventory at this time. To date, we have stopped more than 350,000 refunds determined to be fraudulent, worth more than \$2.5 billion. And this is in addition to the refunds saved on the 400,000 rejected returns.

This January, the IRS also conducted a coordinated and highly successful identity theft enforcement sweep. The coast-to-coast effort against identity theft suspects led to 734 enforcement actions in January, including 298 indictments, informations, complaints and arrests. These activities come on top of a growing identity theft effort that led to 2,400 other enforcement actions against identity thieves during FY 2012.

The IRS also has been working to assist state and local law enforcement agencies in the efforts they are making to fight identity theft-related refund fraud. One way we have done this is by developing the Identity Theft Victim Disclosure Waiver Process, which was launched in Florida in April 2012.

This program provides for the disclosure of federal tax returns and return information associated with the accounts of known and suspected victims of identity theft with the express written consent of those victims. Prior to disclosing any tax information, victims are required to sign a waiver authorizing the release of information to the designated state or local law enforcement official pursuing the investigation. To date the IRS has received more than 1,560 waiver requests from more than 100 state and local law enforcement agencies in the nine states that have been participating in the pilot. On March 28, 2013, the IRS announced that this program has been expanded to all 50 states.

Taxpayer Service

By assisting taxpayers with their tax questions before they file their returns, the IRS helps prevent inadvertent noncompliance and reduces burdensome post-filing notices and other correspondence from the IRS. Accordingly, the IRS provides year-round assistance to millions of taxpayers through many sources, including outreach and education programs, issuance of tax forms and publications, rulings and regulations, toll-free call centers, IRS.gov, Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites.

2012 Filing Season

Despite a number of challenges, the IRS delivered another successful filing season. During FY 2012, the IRS received more than 147.6 million individual returns and issued more than 121.6 million refunds totaling \$333 billion. More than 82.8 million refunds were direct deposited, which is a 4.9 percent increase from the 78.9 million direct

deposited in FY 2011. In addition, IRS employees responded accurately to 93.2 percent of tax law questions and 95.6 percent of taxpayer account questions.

The IRS' e-file program continued to grow, with more than 118.9 million individual returns, or 80.5 percent, filed electronically, an increase of 4.7 percent from the previous year. Other increases in electronic filing results during the 2012 filing season include the following:

- Business returns filed electronically were up by 15 percent to 36.7 percent;
- Filing via home computers increased by 9.8 percent to 43.5 million tax returns; and
- Tax professionals' use of e-file rose 5.4 percent to 75.6 million returns.

Helping Distressed Taxpayers

The IRS' commitment to customer service also means assisting taxpayers who are facing difficult economic times and other hardships. For example, the IRS provided significant support to the Federal Emergency Management Agency (FEMA) in the aftermath of Hurricane Sandy. Before the storm dissipated, the IRS initiated its response, activating 600 employees to answer phone calls beginning on October 29, 2012. That number ultimately grew to 3,000 employees answering 188,175 calls before the Registration Intake Line was deactivated six weeks later on December 4. Given the level of devastation, FEMA also requested IRS assistance in staffing its Help Line, and IRS employees answered 149,000 of those calls. In addition to this direct assistance, the IRS also moved quickly to provide tax relief to victims of Hurricanes Sandy and Isaac through actions such as extending return filing and payment deadlines.

Also in 2012, the IRS expanded the Fresh Start initiative to help struggling taxpayers meet their tax obligations. Changes included:

- Increasing the dollar threshold and repayment period for individual installment agreements;
- Providing more financial analysis flexibility for installment agreements and Offer in Compromise programs;
- Issuing new guidance to address unsecured debts such as student loans, credit cards, and state and local taxes;
- Providing a six-month grace period to certain wage earners and self-employed individuals on failure-to-pay penalties; and

- Extending help to taxpayers eligible for the Innocent Spouse Program by eliminating the two-year timeframe for consideration of certain innocent spouse claims.

IRS.gov and Social Media

The IRS continued to provide alternative service options by increasing the amount of tax information and services available to taxpayers through IRS.gov. In FY 2012, taxpayers viewed IRS.gov more than 370 million times. These taxpayers used IRS.gov to get forms and publications, find answers to their tax questions, and check the status of their refunds. Taxpayers used the “Where’s My Refund?” electronic tracking tool more than 132.3 million times.

The IRS is increasing communications with taxpayers who do not get their information from traditional sources, such as newspapers and broadcast and cable news. By employing social media such as YouTube and Twitter, the IRS reaches these taxpayers and provides important service and compliance messages to them.

Of particular note is the IRS presence on YouTube. We have YouTube videos in English, Spanish, American Sign Language, and other languages. These videos contain useful information for taxpayers. There are now more than 100 IRS videos, which have been viewed more than 5.5 million times. The “Where’s My Refund” video just surpassed one million views this filing season. The IRS now ranks fourth in YouTube viewership among government YouTube channels.

In addition to the IRS presence on Twitter, our social media work has recently been expanded to include Tumblr – a microblogging platform where users access and share text, photos, videos and other information from browsers, smartphones, tablets or desktops. We are using Tumblr to share information about important programs to help taxpayers, such as late tax law changes, the EITC, and Free File.

Also during FY 2012, the IRS released an updated version of its IRS2Go Smartphone application with new features that let taxpayers interact with the IRS using their mobile devices. To date, there have been more than 1.9 million downloads of the application, and more than 6.2 million applications launched. On April 2, 2013, the IRS announced that, for the first time, the IRS2Go application is available in Spanish.

Outreach and Education

The IRS enhanced its outreach and education services during FY 2012 by collaborating with state taxing authorities, volunteer groups and other organizations to address taxpayer needs. By supporting more than 3,900 local partners and a combined 13,143 Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites, the IRS provided free tax assistance to the elderly and the disabled, as well as to individuals with limited proficiency in English.

In FY 2012, nearly 99,000 volunteers prepared almost 3.3 million federal returns and more than 2.5 million state returns, which represent increases over FY 2011 of 2.4 percent and 5.9 percent, respectively. In addition, 95 percent of the federal returns under these programs were filed electronically.

Business Systems Modernization

IRS modernization efforts focused on building and deploying advanced information technology systems, processes and tools to improve efficiency and productivity.

The IRS reached a major milestone in its modernization efforts in January 2012 with the launch of its Customer Account Data Engine (CADE2). Up to this point, the IRS had been performing core account processing on a weekly basis. Launching CADE2 meant the IRS successfully migrated to daily processing and posting of individual taxpayer accounts, enabling faster refunds for more taxpayers, more timely account updates and faster issuance of taxpayer notices.

The IRS also made important progress on another front when Modernized e-File (MeF) Release 7 became operational in January 2012. The enhancements of Release 7 expanded the reach of MeF to cover 100 percent of the 1040 population filing electronically. The IRS processed nearly 107 million individual federal and state returns and more than 14.3 million Business Master File returns through MeF. MeF is a major improvement over the previous system, which processed returns in several batches per day, rather than in real time. MeF reduces turnaround time, improves processing and allows acknowledgments to be sent much more quickly to transmitters.

Working Smarter and Finding Efficiencies

Over the last several years, IRS budget requests have reflected strategic investments in the IRS that 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. Over the past five President's Budget submissions (for FY 2009 through FY 2013), the IRS declared almost half a billion dollars (\$486 million) in budget savings. In addition to these declared savings, the IRS has faced reductions to its budget each year since FY 2010, even as we took on new legislatively mandated responsibilities.

Since FY 2010 and including the current fiscal year, IRS appropriations have been cut by nearly \$1 billion (including over \$600 million in reductions from sequestration and rescissions this year). This represents nearly an 8 percent cut of our annual budget while the total population of individual and business filers grew by more than 4 percent over the same time period. At the same time, we have tackled significant new challenges, including: implementing merchant card and basis reporting, implementing the Affordable Care Act's tax provisions and new requirements for foreign financial institutions under FATCA, and addressing the sharp growth in refund fraud and identity theft.

While the IRS will continue to be an efficient steward of taxpayer resources, improving and investing in our critical programs under continually reduced funding levels has been difficult. Labor is our largest operating expense and we have been very focused on managing personnel costs. We have operated under an exception-only hiring freeze since December 2010. In FY 2012 we secured buyout authority that resulted in the elimination of 1,224 positions that did not involve direct service or enforcement interactions with taxpayers. By closely managing hiring, we reduced the total number of full-time, permanent IRS employees by almost 7,000 between the end of FY 2010 and FY 2012. So far this year, we have further reduced full-time permanent staffing through attrition by another 1,000 full-time employees – thus, we are down 8,000 permanent employees since 2010. Of these, more than 5,000 are front-line enforcement employees.

The IRS has also implemented significant reductions in its non-labor spending. By limiting operating travel to mission-critical needs and increasing the use of virtual delivery for meetings and training, the IRS reduced travel costs by a total of \$158 million in FY 2011 and FY 2012, a 55 percent reduction from FY 2010. Over the same timeframe, we also reduced spending on professional and technical service contracts by \$200 million. Additionally, the IRS generated \$60 million in printing and postage savings by eliminating the printing and mailing of selected tax packages and publications, and by transitioning to paperless employee pay statements.

Finally, in an effort to promote more efficient use of the Government's real estate assets and to generate savings, the IRS announced last year a sweeping office space and rent reduction initiative that over two years is projected to close 43 smaller IRS offices and consolidate space in many larger facilities.

These measures will reduce rent costs by more than \$40 million and reduce total IRS office space by more than 1.3 million square feet by the end of FY 2014. These savings will be realized with little or no impact on taxpayer service or enforcement efforts. Some examples of projects currently underway include consolidating the IRS Detroit Computing Center space for a projected annualized rent savings of \$15.8 million, and a reduction in rent in midtown Manhattan for an annualized savings of \$4.4 million.

IRS Workforce

The IRS remains focused on its efforts to become one of the best places to work in the federal government. We can only serve the nation's taxpayers well if we have engaged employees who are respected and challenged, and whose managers support them, help them do their jobs and hold them accountable.

In 2008, we created the Workforce of Tomorrow task force, which has generated many workplace initiatives to help us achieve the improvements we seek. Last fall, the Partnership for Public Service released the results of the 2012 Best Places to Work in Federal Government survey. It showed the IRS is currently ranked 98th among 292 organizations, only slightly lower than 2011 and still significantly higher than 2010. And

we ranked third out of 15 large agencies – those with 20,000 or more employees – in that survey’s employee engagement index.

In addition, we held our ground or improved our ranking in three of the four IRS Human Capital Strategy Measures. We finished second only to the Department of State in measures related to leadership and knowledge management.

These survey results are especially heartening because of the challenges our employees have faced over the past year, including budget uncertainty and freezes on pay and hiring. These survey results reflect the deep commitment and dedication of the IRS workforce to delivering for the American taxpayer.

THE 2013 FILING SEASON AND TAXPAYER SERVICE

Mr. Chairman, there is much to be proud of this filing season. As noted above, the 2013 filing season has been unique. We faced an extraordinary situation at the start because of tax changes that were not enacted until January 2. After updating forms and completing programming and testing of our processing systems, we opened for business on January 30, allowing the vast majority of individual taxpayers to file their returns.

There were several forms affected by the late tax legislation that required more extensive programming and testing of IRS systems. These included Form 8863 (Education Credits), Form 5695 (Residential Energy Credits), Form 4562 (Depreciation and Amortization) and Form 3800 (General Business Credit). Some of these delayed forms were able to be filed beginning in early February. In early March the IRS completed all remaining programming and testing, and all remaining individual and business taxpayers were able to begin filing their returns on March 4.

Despite all the challenges and delays, the 2013 filing season has been for the most part a smooth one. Refunds have gone out quickly, and the early filing patterns have not affected tax processing or refund speed. The IRS continues to issue more than 9 out of 10 taxpayer refunds in less than 21 days. In addition, our customer service representatives are maintaining a very high level of accuracy in responding to taxpayer questions.

Aiding our ability to deliver a smooth filing season this year is the latest phase of the Modernized e-File system (MeF), which has been working extremely well. MeF is our transaction-based system that processes returns as they are received. MeF provides a robust platform that can meet performance and capacity needs with enhanced and up-to-date technologies. MeF is also improving our communication with tax practitioners through near real-time return receipt acknowledgments.

Submission Processing, Refunds and E-filing

Through April 20, 2013, the IRS received 129.94 million individual returns and issued 93.8 million refunds for a total of \$249 billion. The average dollar refund this filing

season is approximately \$2,650. During the same time period, the IRS directly deposited more than 76 million refunds to taxpayers.

The IRS e-file program continues to grow. As of April 20, 2013, more than 43 million taxpayers prepared their own e-file returns, a 4.4 percent increase over the same time period last year. The percentage of returns filed electronically through April 20 increased to 86.5 percent from 84.7 percent during the same period in 2012.

For FY 2012, it cost only 23 cents to process an e-filed return – a fraction of the \$3.36 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, most taxpayers filing electronically receive their refunds quickly 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.

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 April 13, 2013, IRS telephone assistors answered more than 13.2 million calls. The IRS also completed 35.6 million automated calls – a 9.2 percent decrease compared to last year's 39.2 million calls.

Website Usage and New Media

IRS.gov continues to be the preferred source of information for millions of taxpayers. As of April 13, 2013, there were over 280 million visits to IRS.gov – a 25.7 percent increase over the same time period last year. Use of the “Where’s My Refund?” electronic tracking tool increased 54.7 percent.

As noted above, the IRS also is increasingly employing social and new media to reach taxpayers who do not get their information from traditional sources. The 1 million-plus views for our “Where’s My Refund?” YouTube video is one example of our efforts in this regard. Another is our “tweet” and subsequent “re-tweets” on unclaimed refunds, which reached more than 2 million Twitter followers within 24 hours of the national press release being issued in mid-March.

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 another important resource that provides consistent answers to a limited number of tax law questions using a probe and response process. The ITA will guide taxpayers to accurate answers that are not readily addressed through simple Frequently Asked Questions.

Taxpayer Assistance Centers (TACs)

As of April 6, 2013, more than 1.9 million taxpayers were served at TACs – a 4.6 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 1,900 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 hundreds of tax products have been translated into languages such as Spanish, Chinese, Vietnamese, Russian and Korean.

THE ADMINISTRATION'S FY 2014 BUDGET REQUEST FUNDS KEY PRIORITIES

The FY 2014 President's Budget request is \$12,861,033,000 in direct appropriations and an estimated \$110,627,000 from reimbursable programs, with an additional estimated \$277,582,000 from user fees for a total operating level of \$13,249,242,000. The direct appropriation is \$1,044,337,000 more than the FY 2012 enacted level of \$11,816,696,000.

The overall request is designed to provide the resources necessary to administer and enforce the current tax code, implement recent changes to the Code, conduct a robust and sophisticated enforcement program, and serve taxpayers in a timely manner. Helping taxpayers understand their obligations under the tax law is critical to improving compliance and addressing the tax gap, the difference between taxes owed and taxes paid on time. Therefore, the IRS is committed to making the tax law easier to access and understand, and to improving voluntary compliance and reducing the tax gap through both taxpayer service and enforcement programs.

Enforcement Program

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

Specific areas where the proposed FY 2014 funding will enable the IRS to continue to strengthen enforcement efforts and reduce the tax gap include:

- Strengthening enforcement activities to address offshore tax evasion and expand the IRS' global presence and pursuit of international tax and financial crimes. This includes implementing changes required by the Foreign Account Tax Compliance Act (FATCA) such as new reporting, disclosure and withholding requirements. The IRS will also continue to address tax-avoidance schemes involving unreported offshore accounts;
- Enhancing enforcement activities in connection with partnerships and other flow-through entities, in light of the fact that partnership businesses continue to be the fastest growing segment of all tax returns filed;
- Continuing the IRS' efforts to focus on high-wealth taxpayers by increasing risk identification, case building and examination capabilities; and
- Building on previous efforts to strengthen return preparer compliance, to improve taxpayer compliance and the accuracy of returns filed by tax professionals.

Refund Fraud and Identity Theft

The request provides \$101 million to support IRS efforts to prevent identity theft-related refund fraud, protect taxpayers' identities, assist victims of identity theft, and enhance the revenue protection strategy implemented in FY 2013.

The increase in funding will support the development and implementation of technology enhancements to identify noncompliant returns before refunds are issued, manage and track workload and case results, send notification letters to taxpayers, and allow third-party data to be used earlier in the filing season. This enhancement will improve detection of fraudulent returns and reduce delays of legitimate refunds due to pre-refund

compliance activities. Investment in these activities is projected to protect \$1.3 billion in revenue, once the new hires reach full potential in FY 2016 – a revenue protection return on investment estimated at over \$14 to \$1.

Taxpayer Service Program

The FY 2014 request includes funding to allow the IRS to improve customer service to meet taxpayer demand and continue delivering services to taxpayers using a variety of in-person, telephone and web-based methods, to help taxpayers understand their tax obligations, correctly file their returns, and pay taxes due in a timely manner.

Taxpayer demand for self-service and electronic service options at the IRS has been dramatically increasing in recent years. To support this demand, and to transition taxpayers to less expensive, more efficient operations, the IRS request includes resources to support the Treasury Department's efforts to expand the use of electronic transactions, including new service options that will allow more taxpayers to interact with the IRS through the internet.

Specifically, the IRS is developing taxpayer and practitioner self-service applications that do not exist today, such as viewable eTranscripts, Power of Attorney (POA) and Online Payment Agreements and Installment Agreements.

The increased funding will also facilitate the deployment of 100 new Virtual Service Delivery (VSD) video technology units, which allow face-to-face contact between IRS employees and taxpayers at remote sites through two-way video conferencing. The IRS will be able to resolve taxpayer issues virtually at understaffed and unstaffed Taxpayer Assistance Centers (TAC)s, Taxpayer Advocate Service (TAS) sites, and Low Income Tax Clinic (LITC) locations. VSD video will also allow the IRS to explore connecting virtual tax examinations and other interactions with taxpayers.

Implementation of Tax Law Changes

The FY 2014 Budget requests funding 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. These tax law changes include the reporting provisions related to merchant card payments and third-party reimbursements (included in the Housing and Economic Recovery Act of 2008), and basis reporting on securities sales (included in the Emergency Economic Stabilization Act of 2008). The funding increase will also support compliance activities related to provisions included in the Affordable Care Act (ACA) (Public Law 111-148) such as direct-pay bonds, requirements for tax-exempt hospitals, and the fee on manufacturers and importers of branded prescription drugs.

Business Systems Modernization

The FY 2014 request includes funding that will allow the IRS to build on the momentum of implementing new daily processing in 2012 and the delivery of a new database for individual taxpayer account data by investing in state-of-the-art capabilities, such as online taxpayer services, that leverage the database infrastructure that is now in place. IRS processing systems are now accepting all 1040 forms electronically, and for the first time, are feeding those returns through a single, consolidated database, the Customer Account Data Engine, or CADE2. The next phase of the CADE2 effort will eliminate the risks associated with antiquated technologies and programming languages that are still used in the current IRS environment.

EXPLANATION OF BUDGET ACTIVITIES BY ACCOUNT

Enforcement

The FY 2014 President's Budget request for enforcement is \$5,666,787,000 in direct appropriations and an estimated \$65,619,000 from reimbursable programs, and an estimated \$18,205,000 from user fees, for a total operating level of \$5,750,611,000. To reduce future deficits, a portion of this appropriation, \$245,904,000, is requested as part of the \$411,990,000 total program integrity cap adjustment for the IRS. The adjustment includes an above-base investment in tax enforcement and compliance programs, including \$5,000,000 that will be transferred to the Alcohol and Tobacco Tax and Trade Bureau for high return on investment enforcement activities. In conjunction with specified funds provided in the IRS Operations Support account, this increment will support tax compliance initiatives expected to generate high returns on investment in the form of increased tax revenues. This appropriation funds the following budget activities.

Investigations (\$661,631,000 from Direct Appropriations, and an Estimated \$58,402,000 from Reimbursable Resources).

This budget activity funds the Criminal Investigation (CI) programs that explore potential criminal and civil violations of tax laws; enforce criminal statutes relating to violations of tax laws and other financial crimes; 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. This budget activity 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 & Collection (\$4,842,007,000 from Direct Appropriations, and an Estimated \$6,541,000 from Reimbursable Resources, and an Estimated \$5,000 from User Fees).

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 also includes programs such as specialty tax examinations (employment tax,

excise tax, and estate and gift tax exams), international collections, and international examinations. The budget activity also provides for campus support of the Questionable Refund Program and appeals and litigation activities associated with exam and collection.

Regulatory (\$163,149,000 from Direct Appropriations, an Estimated \$676,000 from Reimbursable Resources, and an Estimated \$18,200,000 from User Fees).

This budget activity funds the development and printing of published IRS guidance materials; interpretations 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 Strategy, 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), is funded within this activity.

Taxpayer Services

The FY 2014 President's budget request for taxpayer services is \$2,412,576,000 in direct appropriations, an estimated \$21,360,000 from reimbursable programs, and an estimated \$151,242,000 from user fees, for a total operating level of \$2,585,178,000. This appropriation funds the following budget activities.

Pre-filing Taxpayer Assistance & Education (\$660,197,000 from Direct Appropriations, \$98,000 from Reimbursable Resources and an Estimated \$10,000,000 from User Fees).

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 (\$1,752,379,000 from Direct Appropriations, \$21,262,000 from Reimbursable Resources, and an Estimated \$141,242,000 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. 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.

Operations Support

The FY 2014 President's Budget request for operations support is \$4,480,843,000 in direct appropriations, an estimated \$23,648,000 from reimbursable programs, and an estimated \$108,135,000 from user fees, for a total operating level of \$4,612,626,000. A portion of this appropriation, \$166,086,000, is requested as part of the \$411,990,000

program integrity cap adjustment for the IRS tax enforcement and compliance programs, which provides an above-base investment in these programs to reduce future deficits. In conjunction with specified funds provided to the IRS Enforcement account, this increment will support new tax compliance initiatives that are expected to generate high returns on investment in the form of increased tax revenues. This appropriation funds the following budget activities.

Infrastructure (\$939,182,000 from Direct Appropriations, an Estimated \$1,044,000 from Reimbursable Resources, and an Estimated \$17,137,000 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 (\$1,305,701,000 from Direct Appropriations, an Estimated \$15,806,000 from Reimbursable Resources, and an Estimated \$31,520,000 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, procurements, and specific employee benefit programs.

Information Services (\$2,235,960,000 from Direct Appropriations, an Estimated \$6,798,000 from Reimbursable Resources, and an Estimated \$59,478,000 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 2014 President's Budget request for business system modernization is \$300,827,000 in direct appropriations. This appropriation funds the following budget activity.

Business Systems Modernization (\$300,827,000 from Direct Appropriations).

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

FY 2014 BUDGET ADJUSTMENTS: EFFICIENCY SAVINGS

Increase e-file Savings -\$5,040,000/ -101 FTE

These savings are the result of reduced paper returns. The IRS projects taxpayers will file 1,587,800 fewer paper returns (666,200 individual and 921,600 business returns) and instead choose to e-file. As a result, the IRS will need 101 fewer FTE in submission processing, generating a savings of \$5,040,000.

Business Systems Modernization (BSM) Savings -\$30,000,000/ 0 FTE

This reduction provides an FY 2014 funding level of \$300,827,000 that is required for the IRS to continue modernization of critical information technology systems that support the nation's revenue base, including the Customer Account Data Engine 2 (CADE2) and Modernized e-File (MeF) programs.

Reduce Information Technology (IT) Infrastructure -\$57,500,000/ 0 FTE

In FY 2014, IRS IT will continue to implement industry best practices to shape the future of information technology development and ongoing operational support, to provide a more robust foundation for expanding IT capabilities in the future. In FY 2014, reductions to IT resources will be managed through streamlining operational requirements. By adopting common technologies, managing demand, and taking advantage of strategic procurement opportunities the IRS will provide a more efficient use of resources.

Implement Human Capital Administrative Efficiencies -\$7,858,000/ -73 FTE

The IRS will achieve human capital administrative efficiencies by reducing costs and streamlining operations. The IRS will take a number of actions to achieve these efficiencies, including: partnering with Treasury to eliminate the redundant costs of collecting duplicate HR reporting data from the National Finance Center; implementing improvements in the Human Capital employment program; and redesigning manager and employee training programs to generate savings.

Targeted Personnel Savings -\$77,766,000/ -683 FTE

Although the budget request calls for increased staffing resources to support a number of strategic priorities, the IRS is also very focused on managing personnel costs and reducing staff across many operational areas. These personnel savings are the result of the annualization of FY 2013 attrition savings. To achieve these reductions, the IRS reduced overall staffing by filling behind critical vacancies only; streamlined the workforce by reducing administrative, analyst and support positions; realigned mission-critical occupations by eliminating positions vacated by employees with outdated skills and hiring employees who have the background and skills to support the IRS in meeting its strategic goals, objectives and priorities; and decreased non-labor costs, such as travel and services, associated with targeted personnel savings

Savings from Space Optimization -76,700,000/ 0 FTE

In an effort to promote more efficient use of the Government's real estate assets and to generate savings, the IRS plans to close, consolidate and reduce its space inventory. In

making these decisions, the IRS will consider such factors as the next closest post of duty, number of employees affected, timing of the lease, alteration costs, number of vacant workstations, and number of field-based employees. As part of this effort, the IRS will develop implementation strategies to minimize the effect on employees.

LEGISLATIVE PROPOSALS

The FY 2014 President's Budget request includes a number of legislative proposals intended to reduce the tax gap and improve tax compliance with minimal taxpayer burden. The Treasury Office of Tax Analysis (OTA) estimates these new tax gap proposals will generate \$77.9 billion over the next ten years, including \$46.5 billion generated by program integrity cap adjustments. The IRS estimates the implementation cost for the tax gap proposals included in the FY 2013 President's Budget that have not yet been enacted, to be \$84.1 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, to provide 10-years (FYs 2014-2023) of funding to the IRS above discretionary caps for program integrity cap adjustments. The proposal would cost \$13.8 billion and deliver \$46.5 billion in additional enforcement revenue, thereby generating \$32.7 billion in net savings over the 10-year budget window.

CONCLUSION

Mr. Chairman, Ranking Member Lewis, let me thank the Subcommittee again for the opportunity to discuss the tax filing season and the FY 2014 budget request for the IRS. We will continue our efforts to be fiscally prudent and make wise investments in strategic priorities in enforcement, service, and business modernization. However, as I have noted, without a change in the current budget environment, the American people will see erosion in our ability to serve them, and the Federal government will see fewer receipts from our enforcement activities.