

**WRITTEN TESTIMONY OF
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BEFORE THE
SENATE FINANCE COMMITTEE
ON IRS BUDGET AND CURRENT OPERATIONS
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INTRODUCTION

Chairman Hatch, Ranking Member Wyden and Members of the Committee, thank you for the opportunity to discuss the IRS's budget and current operations, including efforts to improve taxpayer service.

In allocating resources, the IRS strives to balance three competing and overarching priorities: basic tax administration, sustaining our information technology (IT) systems and modernizing our operations. The President's Fiscal Year (FY) 2019 Budget request attempts to balance these priorities by investing in key mission-critical requirements and build on the work the IRS has already begun in FY 2018 to implement the Tax Cuts and Jobs Act.

This piece of legislation was the first major tax reform legislation in more than 30 years. With hundreds of provisions intended to provide relief to American families and make America's businesses more competitive, the new law will require extensive work by the IRS in calendar years 2018 and 2019 to serve the needs of both taxpayers and tax professionals. It is crucial that the IRS receive additional funding this fiscal year to avoid any disruptions during next year's tax filing season.

The IRS remains mindful of the need to do everything possible to provide taxpayers and their representatives with secure, high-quality assistance and services, through every available channel. The agency spends a significant amount of time and resources each year working to fulfill this critical part of our mission, and our workforce remains dedicated to helping taxpayers understand and meet their filing obligations. Taxpayer needs have been evolving, with more taxpayers conducting their business using digital tools at the time and place of their choosing. The FY 2019 Budget invests resources to meet these needs by reducing dependency on a single point of entry and ensuring the IRS meets the needs of all taxpayers.

The most visible service the IRS provides each year is delivery of a smooth tax filing season. I'm pleased to report that the 2018 filing season began on schedule on January 29 and is going well so far. During Calendar Year (CY) 2017, the IRS received more than 150 million individual income tax returns, 87 percent of which

were filed electronically. We issued more than 111 million refunds for a total of approximately \$320 billion, with the average refund totaling approximately \$2,800.

THE PRESIDENT'S FY 2019 BUDGET

The President's FY 2019 Budget request of \$11.135 billion includes savings and reductions of \$23.7 million and 2,163 full-time equivalent equivalents (FTE) compared to the FY 2018 Annualized Continuing Resolution level.

The Budget invests in high-priority programs to allow the IRS to assist more taxpayers by becoming more efficient and effective. The Budget also invests in technology and data analytics, to increase the use of "lighter touch" compliance contacts and focus enforcement on closing the tax gap, and to protect taxpayer refunds from fraud. Importantly, the Budget increases funding for security and replacing obsolete hardware to protect taxpayers' sensitive data from growing cyber threats. In addition, the Budget requests modest changes to the IRS transfer and reprogramming authority to provide the IRS with the flexibility necessary to manage its resources more effectively.

Operations Support. The President's Budget request includes \$4.16 billion for operations support programs including rent, cyber and physical security, IT services for all IRS employees, and core tax processing and compliance systems. Within that total, \$2.29 billion is allocated for information services, which is \$217.8 million, or 10.5 percent, above the FY 2018 Annualized Continuing Resolution level.

The management, maintenance, and ongoing enhancement of the IRS's information technology systems are central to the reliability of its operations, and to the successful accomplishment of its mission. The 2019 Budget includes dedicated funding to refresh IRS hardware and software to provide a stable foundation for delivering technology services required for day-to-day operations, transforming the taxpayer experience, and modernizing IRS operations.

At the end of FY 2017, more than 59 percent of IRS hardware was past its useful life compared to 64 percent at the end of FY 2016, and 32 percent of software was two or more releases behind the most current commercially-available version. The FY 2019 Budget provides \$187.8 million to enable the IRS to implement critical hardware and software upgrades and reduce system outages and failures.

Sustained investments in IT are also required to improve cybersecurity and ensure the IRS can continue to safeguard taxpayer data. The IRS combats more than 1 million cyberattacks daily, and operates strong network perimeter

defenses to mitigate threats, detect vulnerabilities and monitor network security. The 2019 Budget includes \$303.7 million for these critical activities.

Taxpayer Services. The President's Budget request includes \$2.24 billion for taxpayer services, which is \$108.7 million, or 4.6 percent, below the FY 2018 Annualized Continuing Resolution level. The IRS is mindful of the need to continually improve our efforts to ensure taxpayers can file their taxes as quickly and easily as possible. We will continue expanding opportunities for taxpayers and their representatives to complete service and compliance interactions through their preferred channel, be it online, over the phone, or in-person at one of the IRS's many Taxpayer Assistance Centers (TACs).

At the same time, we will continue our investments in improving the use of online tools and offerings and modernizing the taxpayer experience. Over the last several years the IRS has launched a number of digital applications that allow taxpayers to conduct various transactions online, such as paying their tax bill, having access to certain return information, and requesting an online payment agreement. Our work in this area also includes continuing the development, over time, of online accounts at the IRS where taxpayers can log in securely, obtain the information they need about their account and interact with the IRS as needed.

Effectively serving taxpayers who prefer to be served through electronic channels allows the IRS to reduce costs, increases taxpayer satisfaction and frees up funds to serve those taxpayers who prefer to be served differently. Not only that, efforts to continue improving our online offerings will allow the IRS to simplify return filing for the vast majority of taxpayers. Enhancing taxpayer service in this way will in turn increase voluntary compliance, improve tax administration and increase taxpayer satisfaction.

Enforcement. The President's FY 2019 Budget includes \$4.63 billion for enforcement programs, which is \$21.2 million, or 0.5 percent, above the FY 2018 Annualized CR level. In addition, the Budget also includes a program integrity cap adjustment for improving the effectiveness and efficiency of the IRS's overall tax enforcement program

The IRS remains committed to increasing compliance by assisting taxpayers in fulfilling their tax obligations and enforcing the tax laws. As a result of these efforts, the agency remains one of the most cost-effective investments within the federal government. In FY 2017, the IRS collected \$3.4 trillion in revenue to fund the federal government, which represents more than 90 percent of all federal receipts, and resources invested in the agency lead to significant revenue increases for the nation.

One of the IRS's highest priorities in the enforcement area remains the effort to combat tax-related identity theft and refund fraud. Protecting taxpayers and their

personal data from identity theft is a critical aspect of taxpayer service, and the IRS has worked to improve its efforts in this critical area. During FY 2017, the IRS continued increasing taxpayer protections to make filing a tax return as safe and secure as possible. As a result, the number of fraudulent refunds declined and the number of taxpayers reporting to the IRS that they were victims of identity theft has also declined. The number of victim reports declined from 401,000 in CY 2016 to 242,000 in 2017, a drop of 40 percent.

Business Systems Modernization. The President's Budget includes \$110 million for business systems modernization, which is \$178.0 million, or 61.8 percent, below the FY 2018 Annualized Continuing Resolution level.

To gain efficiencies, secure and protect data, and reduce the resources necessary to maintain existing systems, the IRS will continue efforts to modernize its systems. Our main initiatives in this area are: expanding the digital conversion of paper case files, automating repetitive manual processes, leveraging existing data to detect tax noncompliance earlier, and enabling a strong and secure systems platform for taxpayer-facing applications.

FUNDING REQUEST TO IMPLEMENT THE NEW TAX LAW

Implementing the Tax Cuts and Jobs Act is one of the IRS's highest priorities. The IRS has established a Tax Reform Implementation Office, led by one of its most senior leaders, to ensure its successful administration. Preliminary efforts to implement this new law are already underway, and two important pieces of guidance related to the new law have already been issued: on December 29, 2017, the IRS issued notices that address amended section 965 of the Internal Revenue Code and the new section 1446(f).

Additionally, the IRS and the Treasury Department released new withholding guidance indicating that employees should see the tax reform changes reflected in their paychecks as early as this month.

Additional published guidance on the new tax law will be provided as the IRS continues to analyze the law and its impact on tax administration. On February 7, the IRS and the Treasury Department issued a revised Priority Guidance Plan that includes projects related to the law.

To ensure successful implementation, the IRS will need additional resources in FY 2018. After considering FTE staffing needs and non-labor costs, preliminary estimates indicate the IRS would need at least \$397 million to implement tax reform. This funding is needed immediately to ensure that the IRS can start critical implementation activities on time. The funding should be available for two years to ensure contracts can be let appropriately and resources are available

throughout the critical testing period of September through December of the calendar year, the first quarter of FY 2019.

Activities to implement tax reform will include: re-programming approximately 140 interrelated return processing systems in conjunction with creating or revising approximately 450 tax forms, publications and instructions; publishing guidance, notices, and Frequently Asked Questions (FAQ); preparing the IRS workforce to help taxpayers understand how the new law applies to them; and importantly, providing taxpayer assistance and outreach.

These estimates reflect one-time costs associated with updating major systems and enabling the IRS to quickly respond to the new tax law changes and anticipated higher taxpayer demand for assistance in 2018 and 2019. As with other major investments, the IRS expects some recurring operations and maintenance costs which will be funded within base appropriations.

The \$397 million funding request for tax law implementation includes the following:

- \$291 million for updating information technology systems;
- \$75 million for taxpayer assistance, education and outreach;
- \$3 million for creating and revising tax forms, instructions and publications;
- \$15 million for developing and issuing published guidance and notices;
- \$8 million for tax and information returns processing; and
- \$5 million for program management.

LEGISLATIVE PROPOSALS IN THE PRESIDENT'S FY 2019 BUDGET

Along with the funding requested in the President' FY 2019 Budget, we are also asking for Congress's help legislatively, particularly in four important areas that would improve tax administration and support the IRS in fulfilling its mission:

Program Integrity Cap. In addition to the base appropriations request of \$11.135 billion, the FY 2019 Budget proposes a \$362 million program integrity cap adjustment to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS's overall tax enforcement program.

The Budget also proposes additional cap adjustments to fund new initiatives and inflation. The investments will generate about \$44 billion in additional revenue over 10 years and will cost about \$15 billion for net savings of \$29 billion. Notably, the return on investment (ROI) likely is understated because it does not reflect the effect that enhanced enforcement has on deterring noncompliance.

Streamlined Critical Pay Authority. The IRS Restructuring and Reform Act of 1998 increased the IRS' ability to recruit and retain a small number of key

executive-level staff by providing the agency with streamlined critical pay authority. This allowed the IRS, with approval from Treasury, to move quickly to hire well-qualified individuals to fill positions deemed critical to the agency's success, and that required expertise of an extremely high level in an administrative, technical or professional field. Executives hired under this authority included our former Chief Information Officer, a senior cybersecurity expert, our system architect, the director of our online systems development team and other senior IT executives. This authority expired at the end of FY 2013. The last appointment made under Streamlined Critical Pay authority expired on September 29, 2017. Without this authority, the IRS continues to face challenges recruiting and retaining top-level talent, especially IT professionals who can help modernize our IT systems and protect taxpayer data from cyberattacks. The President's FY 2019 Budget request proposes reinstating this authority through FY 2022.

Correction Procedures for Specific Errors. Under current law, the IRS has authority in limited circumstances to identify certain computation mistakes or other irregularities on returns and automatically adjust the return for a taxpayer. At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific, newly enacted tax code amendments. The IRS would be able to significantly improve tax administration – including reducing improper payments and cutting down on the need for costly audits – if Congress were to enact a proposal in the President's FY 2019 Budget to provide the IRS with greater flexibility to correct specific errors on taxpayer returns. This proposal would allow the IRS to correct errors in cases when the information provided by the taxpayer does not match the information contained in government databases, or when the taxpayer has exceeded the lifetime limit for claiming a deduction or credit.

Authority to Require Minimum Qualifications for Return Preparers. The President's Budget request proposes providing the Secretary with explicit authority to require that all paid tax return preparers have a minimum knowledge of the Code. This is especially important to ensure that the estimated 400,000 tax preparers without credentials can meet minimum standards for competency. Incompetent and dishonest tax return preparers harm taxpayers by subjecting them to potential audits and by potentially subjecting them to penalties and interest as a result of incorrect returns. Requiring all paid tax preparers to keep up with changes in the Code would help promote high-quality service from preparers, improve voluntary compliance and foster taxpayer confidence in the fairness of the tax system.

Chairman Hatch, Ranking Member Wyden and Members of the Committee, that concludes my statement. I would be happy to take your questions.