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THE PRESIDENT'S FISCAL YEAR 2025 IRS BUDGET AND THE IRS 2024 FILING SEASON

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED EIGHTEENTH CONGRESS

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THE PRESIDENT'S FISCAL YEAR 2025 IRS BUDGET AND THE IRS 2024 FILING SEASON

TUESDAY, APRIL 16, 2024

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:36 a.m., in Room SD–215, Dirksen Senate Office Building, Hon. Ron Wyden (chairman of the committee) presiding.

Present: Senators Cantwell, Menendez, Carper, Cardin, Bennet, Casey, Warner, Whitehouse, Hassan, Cortez Masto, Warren, Crapo, Grassley, Cassidy, Lankford, Young, Barrasso, Johnson, Tillis, and Blackburn.

Also present: Democratic staff: Grace Enda, Tax Policy Analyst; Jonathan Goldman, Senior Tax Counsel, International; Eric LoPresti, Detailee; Joshua Sheinkman, Staff Director; and Tiffany Smith, Deputy Staff Director and Chief Counsel. Republican staff: Courtney Connell, Chief Tax Counsel; Michael Gould, Tax Counsel; Gregg Richard, Staff Director; and Don Snyder, Senior Tax Counsel.

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The Finance Committee will come to order. Today the committee meets to discuss the IRS budget and tax filing season, which closed yesterday. I want to thank Commissioner Werfel for being here at a very busy time for everybody at the agency.

There are lots of issues to discuss, and one that certainly is important to the American people is Direct File. Anyone who denies that the Direct File pilot was a huge success, my guess is, is just living in another universe. It was open to a fairly small percentage of taxpayers, but the reviews it got from its initial users were overwhelmingly positive.

It seems like a whole lot of people were very stunned that a Federal agency, particularly one as frequently vilified as the IRS, was able to build a helpful website that works. The tens of thousands of taxpayers who used Direct File this year collectively saved millions on fees that they would have paid to one of the tax software giants.

The website was user-friendly. It was quick and easy to use. It did not hassle users with upcharges for add-on services they did not need. Direct File showed that the IRS could build a good tool that people like because it saves Americans time and money. No

surprise then that people who oppose it are absolutely furious, and once again are doing everything they can to stop it from growing.

The detractors said it did not attract enough users, but tens of thousands of new users came in over the last week. The IRS hit its goal of 100,000 taxpayers using the system. There is no doubt in my mind that this will be more popular every year.

Others have said that the cost estimates were too vague. But the fact is, there are always challenges with pilot programs. Now that the IRS has tested this system and set a baseline, the costs are going to be clear going forward.

Finally, there are some who said the whole project was unnecessary. They have said that taxpayers have the option of using "free file" systems through the big tax prep companies. They may have had a valid argument years ago, before the tax prep giants got caught hiding free file options from eligible taxpayers. They were conning people into forking over hundreds of dollars they did not need to spend. Congress simply cannot go around trusting the big tax prep companies to do the right thing. For some of them, their version of free file is the freedom for Americans to pay them even more.

Bottom line: Direct File is long overdue, and it is the kind of public service the Federal Government ought to be providing to Americans whenever it can. I understand the IRS and Treasury Department are now evaluating how the pilot program went over the last few months. Personally, I believe that this program should be expanded.

I am looking forward to the day when Oregonians come up to me in one of our 51 Fred Meyer grocery stores—I have been to every single one of them, having had a chicken in each one—to tell me how thrilled they were to save time and money with Direct File.

On the topic of vastly improved Federal programs, I will turn now to the IRS's continued success in improving customer service during the filing season. The IRS answered a million more calls with live assistance than it did during last year's filing season. It got call waiting times down to 3 minutes. It saved taxpayers 1.4 million hours of time that in previous years they would have spent basically listening to all the music and just being on hold. It smashed its goals for in-person service.

Despite the success, apparently there have been some complaints from the other side of the aisle that the administration is asking for money to sustain this progress. I am not sure what is behind that. Maybe they want to go back to the bad old days when taxpayers sat on hold for hours and could not get timely refunds. It does not make any sense to me.

For the second filing season in a row, the IRS is proving that it can provide a top-notch level of taxpayer service when Congress gives it the resources.

Just a few words, to close, on enforcement. The IRS has announced some major enforcement efforts in the last few months. This includes cracking down on 125,000 cases where wealthy individuals—many of them people who bring in more than a million dollars a year—never even filed a tax return. Let me repeat this. This is not people who figure out how to game the system. They

are sufficiently contemptuous of the rules that they never even filed a tax return.

There is also a new effort to root out the abuse of tax breaks for corporate jets—high-flying executives who take tax write-offs for personal travel, for example.

In my view, the IRS ought to look at similar abuses with corporate-owned yachts. When it comes to yachts, the abuses seem to me to be even more blatant. Yachts produce big write-offs, but I find it hard to believe that anybody is yachting to a board meeting.

If Congress continues to cut the IRS's funding, or if the Inflation Reduction Act funding expires and Congress does not add more, we know exactly what will happen. Wealthy tax cheats will have an easier time getting away with breaking the law. And that means misery for typical Americans who are just trying to do their civic duty when tax filing season comes around every spring. That is an outcome that the vast majority of the American people oppose.

Lots to discuss this morning, colleagues. I want to thank Commissioner Werfel for joining us. I look forward to the questions and answers.

Senator Crapo?

[The prepared statement of Chairman Wyden appears in the appendix.]

OPENING STATEMENT OF HON. MIKE CRAPO, A U.S. SENATOR FROM IDAHO

Senator CRAPO. Thank you, Mr. Chairman. And welcome again, Commissioner Werfel.

I agree with and appreciate the work that you are doing and the progress that you have made. There are going to be issues that are raised today, however. The IRS needs to be accountable for the choices it makes, become more efficient, rigorously plan, provide full transparency, and solicit real feedback from informed stakeholders like Congress before acting. Despite claims that the $80 billion in new funding would transform the IRS into a 21st-century agency, the President's budget request indicates otherwise.

While modest progress has been made, there are other areas where the agency continues to miss the mark. For example, last year I raised concerns with the IRS's strategic operating plan, including its vagueness and missing line-item cost projections. A year later, we are still missing important details.

Yet this year's budget asks for even more unprecedented IRS funding, more than $104 billion. This underscores that the initial windfall was not a cure. The IRS has not transformed, and the President believes the only way that that vision can be achieved is to spend more. While I support a transformed IRS, this approach is not the solution.

For $80 billion, one would expect transformational customer service changes and fully modern front-end and back-end IT. Instead, it seems that taxpayers have paid for mail to actually be opened, and a decline in the phone wait times. Meanwhile, several million items of taxpayer correspondence remain unanswered, and half a million ID theft cases remain unresolved, on average, years later.

IT modernization funding is also scheduled to run out years before the IRS finishes updating its systems. I assume that this is due in part to the bulk of the IRA funding being directed to enforcement. I do not disagree with the enforcement needs that my colleague the chairman has identified.

An emblematic example of the "just spend more, no questions asked" approach though is the Direct File program. Despite there already being multiple free filing programs—I say that again, multiple free filing programs offered by the IRS—the agency embarked on a redundant government-run tax preparation project complete with all the attendant inefficiencies and conflicts of interest.

Just last week, a Government Accountability Office report highlighted many ways the supposed pilot program has not followed best practices, including key planning, budgeting, and accountability failures. The report noted that while GAO could not determine how much the program has and will cost to develop and operate—the IRS having not provided sufficient information to do this—the current tab far exceeds $100 million, just through Fiscal Year 2024, for an option that might only serve 100,000 taxpayers this year.

In contrast, the Federal Government spends less than $5 million a year to have 2 to 3 million taxpayers served in one of its free income tax preparation programs. Were the IRS to use this year's Direct File spending to pay third-party providers to prepare and file returns instead, literally hundreds of times the number of taxpayers could file for free. The IRS spending hundreds of millions of its finite funding to simply test the utility of doing something that can already be done more efficiently, with better outcomes and without the very real conflicts, while simultaneously pleading for more funding, calls for more oversight.

Direct File is not my only concern with the IRS's current path. Other serious concerns include the continued IRS use of biased data and post-facto metrics to plan and justify its actions; indiscriminate IRS enforcement campaigns that pressure honest taxpayers and waste government resources; and the IRS's continued—and highly disproportionate—focus on increasing enforcement over improving taxpayer services.

Commissioner Werfel, while I appreciate the positive steps the IRS has taken during your tenure, so much remains undone at the IRS that any victory lap is unwarranted. I look forward to your testimony, Commissioner Werfel, and I thank you, Mr. Chairman.

[The prepared statement of Senator Crapo appears in the appendix.]

The CHAIRMAN. All right. Our witness today is Commissioner Daniel I. Werfel, 50th Commissioner of the IRS. Previously he was a managing director and partner at the Boston Consulting Group. Before joining them, he was nominated to be the Controller of the Office of Management and Budget, a post he served in for 4 years before becoming Acting Commissioner of the IRS in 2013. He began his career at the Office of Management and Budget in 1997 as a policy analyst in the Office of Information and Regulatory Affairs.

Commissioner, welcome. Please go ahead.

STATEMENT OF HON. DANIEL I. WERFEL, COMMISSIONER, INTERNAL REVENUE SERVICE, WASHINGTON, DC

Commissioner WERFEL. Chairman Wyden, Ranking Member Crapo, and members of the committee, thank you for the opportunity to testify on the filing season and the IRS budget. I am pleased to report that the 2024 tax season opened on schedule on January 29th, and we have seen a historic filing season unfold since then.

Through April 6th, the IRS received more than 101.8 million individual income tax returns and issued nearly 66.8 million refunds for more than $201.1 billion. The Inflation Reduction Act funding has enabled the IRS to have one of its best filing seasons ever, in terms of customer service. Taxpayers are seeing a difference.

We have answered over 1 million more taxpayer calls than we did a year ago, and 3 million more calls than we did in 2022. Wait times and level of service on our main phone lines have improved. We have dramatically expanded service in our walk-in sites, increasing hours and serving more taxpayers; and new and expanded tools on *irs.gov* are seeing heavy use.

We had several ambitious transformation goals at the start of filing season, and IRS employees worked hard to deliver. Here are some examples through early April. We committed to an 85-percent level of phone service on our main taxpayer helpline during the filing season. As of early April, we exceeded that goal at 88 percent. That is a huge improvement from 2022, when only 15 percent of calls could connect and receive support from a live assistant.

We committed to an average call wait time of 5 minutes or less on the agency's main taxpayer helpline. We exceeded that goal, with our main line phones being answered in about 3 minutes. These are some of the examples of how we are seeing historic improvements in taxpayer service, and the agency is rebounding from some very tough and lean years during the past decade.

At the same time, the Inflation Reduction Act funding has enabled us to begin making critical inroads in addressing tax evasion amongst the most complex and largest filers. This is a sharp turnaround from the past decade, when we were hindered by a lack of resources.

Our compliance work includes focusing on tax delinquencies and nonfiling among high-income individuals, areas we are particularly concerned about. We are also responsibly leveraging artificial intelligence and hiring subject matter experts to find tax evasion amongst the largest and most complex partnerships and corporations.

I want to be clear. Despite the improvements this tax season, the IRS still has much more work to do on many fronts. This includes closing remaining gaps on phone service, expanding digital options for all taxpayers, further strengthening data security, and supporting vulnerable populations by protecting them from scams and increasing access to the Earned Income Tax Credit and other refundable credits.

Our ongoing success hinges on sustained investments, to make sure that we have the right size workforce with the right training and tools, as well as modern technology infrastructure with increasingly modern web-enabled tools for taxpayers. These are need-

ed to ensure the IRS continues our transformation work to serve the Nation today and in the future.

Helping us in these efforts is the administration's Fiscal Year 2025 budget proposal. It gives us flexibility and increases IRS transfer authority, so all available resources can be used efficiently and effectively. It will also help sustain a new IRS baseline of resources and avoid immediate funding cliffs that will dramatically degrade our ability in many different areas, including the service improvements that taxpayers saw this filing season.

The 2025 funding is necessary for us to build on our successes this filing season and continue our work to, for example, make further phone service improvements and provide digital tools to help taxpayers. For the IRS to be able to do all these things, adequate annual discretionary funding and complementary long-term mandatory funding are both essential.

Finally, I want to publicly thank taxpayers for taking the time to file and pay their taxes this filing season. This is a critical component that citizens do to support our great Nation. Please know that all of us at the IRS deeply appreciate and respect the time and care taxpayers take to do this vital civic duty, and IRS employees remain committed to helping taxpayers that we can.

Chairman Wyden, Ranking Member Crapo, and members of the committee, that concludes my statement. I would be happy to take your questions.

[The prepared statement of Commissioner Werfel appears in the appendix.]

The CHAIRMAN. Commissioner, thank you, and we very much appreciate your being here.

So, you have experience in both the public and the private sector, and it seems to me that launching something like Direct File is a little bit like starting a startup company.

Tell us, from a business perspective, how has this project launch gone?

Commissioner WERFEL. It has gone very well. I think of it as a product launch. We are putting a new product on the street, if you will, and our customers, in this case taxpayers, are going to let us know if the product is working effectively, and if they think they would like to use the product in the future.

So, we started like any private-sector company would. We had the idea for the product, and then we put it on the street with volunteers. We tested it.

So, from about January 29th to March 8th, the Direct File product was in testing with volunteer taxpayers who agreed to submit. We got very positive reviews, but we were also able to make real-time fixes to the product, based on taxpayer experience.

On March 8th we were ready to go, and that is when we made it publicly available to the millions of taxpayers in 19 States who were eligible this year. The feedback has been great. People are telling us that it is easy to use, it is simple. Of course, they like the price tag. It is free, and as you mentioned, Mr. Chairman, in the final days of the filing season, we saw an extraordinary increase in the pace of taxpayers filing with Direct File, and it all went very smoothly.

The CHAIRMAN. Okay.

Let's talk about the massive fraud that we are seeing now in the Employee Retention Tax Credit program, and as we all know, this was a real help to lots of people during the pandemic. But a whistleblower told me not too long ago that there is now an avalanche of fraud. Something like 95 percent of the claims now being made are fraudulent, choking the IRS systems and delaying valid refunds.

Now, the bipartisan tax bill that I introduced with Chairman Jason Smith over in the House would cut off the claims after January 31, 2024 and give the agency new enforcement tools.

My question to you is, if this Senate fails to take action on this bipartisan tax agreement, it seems to me fraudulent ERTC claims are going to continue to clog the system. That is going to cost taxpayers billions of dollars, and it is going to divert resources away from law-abiding taxpayers. Your thoughts?

Commissioner WERFEL. Yes. I absolutely agree, Mr. Chairman. We issued a moratorium on September 14, 2023 because, over the summer of 2023, we were seeing an increasing number of questionable claims coming in, and we were worried, not just about the financial bottom line of the U.S. Government, we were worried about honest small businesses that we saw were being taken advantage of by aggressive marketers and promoters, convincing these small businesses that they were eligible for a credit they were not truly eligible for.

And they were saying, "You can get this credit at no risk to you," and that was not true. So, it was also false advertising. So we had to take steps to stop the flow, and we did slow it. But even today, Mr. Chairman, we are still getting 20,000 new claims every week, even when we announced in September that we stopped processing. This is because the law allows these claims to be submitted through 2025, and these promoters are out there still pushing for these claims to be filed.

I really do appreciate the legislation that you are sponsoring with Chairman Smith in the House that would give us the tools. There are two things being harmed if that bill does not get passed: one, the financial bottom line of the U.S. Government, because you are giving us tools to crack down on fraud; and two, in our big inventory of claims, there are still eligible claims in the mix. But they are very hard to find. It is like finding a needle in a haystack. So, with your help, we can get those eligible claims found and issued, and hold back from issuing the ineligible claims.

The CHAIRMAN. Well, I talked to Chairman Smith late last night, and he wanted me to say we are pulling out all the stops to get this legislation passed. If I were to go through all of the groups, conservative groups, progressive groups, and other groups who are for this legislation, we would still have you here tomorrow morning at breakfast, so I am not going to do that. But we are pulling out all the stops to get this passed.

The last question I want to ask deals with IRA funding and customer service. The funding provided by the IRA this filing season seems to have been a major success. The IRS cut call wait times to 3 minutes, expanded the customer callback service, and opened or reopened 54 sites for in-person service. There are new digital

tools, and you scanned millions of paper-filed returns. That ought to speed up some refunds.

Commissioner, how will taxpayers notice that IRA funding has improved service this year, A; and B, so we get this in, what would taxpayers notice if the funding were cut?

Commissioner WERFEL. Well, taxpayers I believe—and I have heard from them—have seen and felt a big difference in the past 2 years, and in particular this year. We are putting Inflation Reduction Act funds to good use to serve taxpayers.

How? We now have the right number of phone assisters in our phone center. They are trained, they are answering the phone calls at peak efficiency. The wait time is down to 3 minutes, and we used IRA funding to modernize our call center with things that taxpayers want, like a callback option, and like more chatbots and automated solutions, so you do not have to wait on the phone if what you can get done with the IRS can be done by pressing a button or speaking out loud.

So, these are things that taxpayers are seeing and feeling and are making a difference. We are also using Inflation Reduction Act funding to update *irs.gov* with new tools. There are things that people can do on their individual online accounts now, updates to Where's My Refund?

We had over 500 million hits to *irs.gov* this year. It is a record for us, and we believe that is because we have updated it with tools that taxpayers are finding useful, like for example, being able to submit documentation to the IRS electronically rather than on paper at the post office.

So all of that needs to be sustained, and this is what is critical about our budget proposal. Our budget proposal is not saying we need a lot more money to get the job done. We have gotten, for example, the service to an extraordinarily high level.

The money we are asking for in the out-years of the President's budget is to sustain. We do not want to lose those 5,000 new assisters. We do not want to have to fire them or lay them off. That means that phone calls will not get answered. So the funding that we are asking for is making sure that we can sustain the right size customer service workforce and the right tools, so this new service level that we have achieved can be sustained into the future.

The CHAIRMAN. I am over my time.

Senator Crapo?

Senator CRAPO. Thank you, Mr. Chairman.

Commissioner Werfel, the first issue I want to talk with you about is identity theft case resolution.

Commissioner WERFEL. Yes.

Senator CRAPO. I assume you are aware we have some significant issues with that in Idaho. I think they are existing all across the country. According to data provided by your staff, on average it is currently taking the IRS almost 2 years to resolve ID theft cases flagged by taxpayers to the IRS.

Your staff also indicates that the IRS currently has a backlog of almost 600,000 such cases. During the time a taxpayer awaits the IRS resolving a case, many negative outcomes can occur, including the IRS itself taking actions that could harm the already victimized taxpayers, such as imposing liens or levies.

As a sign of how pervasive and troubling these cases are, I am aware of instances where State and local governments have reached out to Congress to assist with their own ID theft cases. Now, I am not asking you to comment today on any particular case, though my staff has been in touch with you and your staff with regard to some of these.

Speaking generally to all of the cases, I am concerned—and certain that you would agree—that taking years to identify and resolve ID theft victims' claims and problems is unacceptable, and that both the delinquent resolution time and the sheer volume of the backlog needs to be improved rapidly.

Would you agree to provide me, no later than your responses to the committee's other questions for the record, with a report detailing the concrete steps that the IRS will hereafter take to quickly and thoroughly resolve these unresolved ID theft cases, as well as analysis of the reasons why there are so many of these cases in the first place?

Commissioner WERFEL. Yes, absolutely. We will commit to that.

Senator CRAPO. Well, I appreciate that. This is something that really needs to be highly prioritized.

The next issue that I would like to go to with you is basically the Direct File and what I see as a lack of transparency regarding the way that it has been managed.

When you last testified before this committee, I raised concerns with the wasteful and duplicative Direct File program, that at the time the IRS was allegedly only studying. You assured me then that no decision had been made on moving forward with the Direct File.

A week later you told House Ways and Means Committee members that you would produce a study and then you would come back and talk about it with Congress. What happened is that, the very same day you issued your study—which both GAO and TIGTA have since flagged as missing key information and analysis—you announced that the IRS was going to launch Direct File.

Putting aside policy concerns with respect to Direct File, my question for you is, do you believe that the IRS has statutory authority to implement the Direct File program?

Commissioner WERFEL. I do.

Senator CRAPO. And what is that authority?

Commissioner WERFEL. We have authorities under the Internal Revenue Code to provide taxpayer service to taxpayers and update the tools and solutions that taxpayers use to file. So, we lived in a world where we had only paper forms. Then we moved to a world where, for example, we can put a PDF form on the web, and people can fill out that PDF form on the web. We did not need congressional authority to do that.

We worked to develop, as you mentioned in your opening statement, a partnership with the Free File Alliance, with commercial software providers, to work with them and support their efforts to support free electronic solutions. We did not need congressional authority to do that.

And now we stand here where we are hearing from taxpayers—not every taxpayer but some taxpayers—that they want an additional option. They want an additional—they have paper. They can

go on a PDF file on the web. They can work with a commercial software provider. We did not—IRS did not ask for legislative authority. Now there is just yet another option on the menu.

It is our assessment that we have the authority to add such options on the menu. Maybe there is another option that is going to come after Direct File. Again, this is about the IRS working with taxpayers, serving their best interest, and making sure we are giving them options to make their life less stressful and easier as they file their taxes.

Senator CRAPO. Well, I will pursue this with you more later. I only have time for one last question, and I need to get this question in. This is the budget request for another $104 billion.

Commissioner WERFEL. Yes.

Senator CRAPO. You stated before that the IRS would have a decade to rebuild with the $80 billion in IRS funding, and there would be a healthy pressure to immediately take the funds and demonstrate what a well-funded IRS means. At the time, when many of us raised concerns about that level of funding, which was five times or more of the budget of the IRS, it was stated, well, we need that money to maintain these employees. Now I am understanding that we need the $104 billion more to maintain the employees of the IRS.

I guess in part, my question could be, when will it stop? But my question is, now that the IRS has requested an additional, more than eight times its annual budget for more new mandatory multiyear spending, when is it going to end? What is the actual amount of doubling, tripling, multiplying the size of the IRS budget in order to accomplish whatever the objectives are you say can't be accomplished with what has been provided?

When will we see the end of the amount of phenomenal multiplications of the size of the IRS in budget requests?

Commissioner WERFEL. Yes, I am glad you asked the question, Senator. I would like to take a moment just to explain our budget as quickly and easily as I can. We have a base budget, and then we have a modernization budget, and our base budget is too small to serve the tax system that we have today.

Our base budget is roughly the same as it was in 2010, and the tax system has grown in a variety of different ways: more filers, a gig economy, more complexity, thousands of changes to the tax code. So, as the tax system grows and our base budget stays constant, we have to rely on the modernization funds to close that gap.

And so, what we are asking for in the funding is to basically create a new baseline, so, as the tax system continues to grow, we have the right setup to run the train schedules that are created by that tax code. It is not about asking for more and more and more money to build an ever-increasing IRS. It is about achieving a baseline, because what happens in the out-years is, all the money goes away.

So, if you look at 2026, we lose all of our ability to maintain services. If you look at 2028 and 2029, we lose all of our ability to maintain technology, because there is a cliff. So what you are describing as a concern is really just intended to address the cliffs in the out-years.

And so, when taxpayers came to us this year, and we were able to answer close to 9 out of 10 of their calls in 3 minutes' time, what the President's budget is saying is, please make sure that the same result exists in 2026, 2027, 2028, and 2029. That is all the President's budget is asking.

Senator CRAPO. So, a new baseline that is 800 percent of the existing baseline?

Commissioner WERFEL. It is not 800 percent. I would say it is, you know, it is close—it is different in services than it is in operations. But currently we are about $2 to $3 billion a year off of our services baseline, as an example. And by the way, the tax system continues to grow. So, I can show you all the math and work with your team on that.

But I want to be clear that the increased money is really a combination of making sure that we can provide digital tools to taxpayers, but also just run the train schedules that we have today, and overcome these cliffs that are coming. Thank you.

The CHAIRMAN. Okay. Senator Carper then, followed by Senator Grassley.

Senator CARPER. Yes. Thanks so much.

I think it was 14 months ago that you sat at this table, and behind you was not your leadership team from the IRS but your wife, your kids, your parents. I thanked them at the time for sharing you with all of us, and just convey to them I still feel that way, and I am encouraged by the leadership that you are providing.

I want to say to my colleagues on both sides of the aisle, some of us previously served as Governor. In Delaware, we do not have an IRS. We have a Delaware Division of Revenue, which used to provide lousy service, and we did not do a very good job collecting taxes that were owed.

We went to work on that. We did not fix it in a year. We did not even fix it in one term of mine, but we fixed it in 8 years. After I stepped down, the year that I stepped down as Governor of the State of Delaware, the Delaware Division of Revenue earned and received a quality award for service among all the businesses and nonprofits in the State of Delaware.

The quality award is like, are you kidding? No, we are not. We learned to provide great service. We learned to do a better job of collecting the revenues we were owed, and we balanced our budgets 8 years in a row, in large part because we had done that.

And so, it can be done. It cannot be done overnight, and it cannot be done without support. It cannot be done without leadership. Thank you for providing that leadership.

I want to talk a little bit about Direct File, if we can. The Direct File program we talked about already, but it is a major step toward improving the taxpayer experience. And this year taxpayers in, I think, 12 States could directly file with the IRS through Direct File.

I look forward to working—we look forward to working with you and your team to build on the success of this year's pilot, to bring Direct File to taxpayers in all 50 States, including the first State of Delaware.

Question: Commissioner Werfel, does the IRS plan on continuing Direct File for next tax filing season, and do you plan on expanding the scope of the program for the next filing season, and if so, how?

Commissioner WERFEL. Senator, as we sit here today, the Direct File pilot is still ongoing, because Massachusetts is one of our pilot States, and because of Patriots Day they have until April 17th to file. So the pilot is not done yet.

Here is the plan. Once the pilot is complete, we will gather the data—and we have already started gathering the data—and we will report out publicly the information, including cost. And Senator Crapo mentioned in his remarks a cost estimate that may exceed $100 million.

I am not seeing that in some of the early data that is coming in; not even close to that. So I am looking forward to having a public discussion around what we saw, what the demand was, what the performance of the product was, and what the cost was once the pilot wraps up. We are, you know, a couple of days away from that.

Once we can get that information out into the public space, I would expect we are going to hear from some stakeholders, and we are going to hear from taxpayers, and we are going to hear from States, and we are going to hear from members of this committee and members from House Ways and Means.

And then we will make a decision. I will consult with Secretary Yellen, and we will make a decision about the future of Direct File. The results have been encouraging. There was significant demand for the product. When we released it on March 8th to the broader public, we anticipated at that time, based on traffic, we would see about 100,000 users by April 15th. We blasted through 100,000 on April 13th or 14th, and we are still getting more returns in.

So, demand exceeded what we thought the day we launched the product widely, and then in terms of costs, we are still gathering information. But I do not see anything in the data, early data, that points to over-exorbitant costs. But again, we want to have that public discussion, and then we want to make a decision as transparently as we can.

Senator CARPER. Good. Thank you for that.

I am going to stick with Direct File for just another moment, if I could. How can Congress, how can we on this side of the dais, support the Direct File program and ensure that more States, including my State, can participate next year?

Commissioner WERFEL. Yes. I think it is about making sure there is balanced information out there about what the ambition of Direct File is. It is intended to be an option, not intended to be mandatory. It is still taxpayers preparing their own taxes. It is not the IRS preparing the taxes for you.

People can opt out of it any time they want and switch products, and we want to hear from taxpayers in Delaware and other States more broadly, what do they want from the IRS to make the tax filing process as seamless and easy as possible? How can we reduce their stress?

A lot of taxpayers are telling us a free solution to work directly with the IRS online is one option they would like to have. They might not use it, but they want it on the menu. We want to hear

from your citizens in Delaware what they think, so that we can be ever more informed in how we serve taxpayers most effectively.

Senator CARPER. Good; thanks.

Mr. Chairman, when we were House members a million years ago, and Senator Grassley was a House member as well, we used to hold a lot of town hall meetings in our respective States. Every year right around tax filing season, I would host up and down the State—we only have three counties. But in every county, we would bring in the Division of Revenue. We would bring in the IRS.

We would help people file their taxes, prepare their taxes, and would actually have an exercise where people in the audience could help us balance the budget. It was really interesting, and we would have like 50 to 100 people there.

One year we were having a hard time; I think my group was having a hard time with citizens. We were having a hard time balancing the budget, and we had to work on defense spending, nondefense spending. We worked on entitlements and still could not balance the budget in the exercise.

A lady in the back of the room raised her hand. I said, "Yes, ma'am?", and she said, "We're having a hard time. Would you have any thoughts?" "Well, you have not thought at all about revenues in trying to get us to this. Revenues are part of the solution. It is not just raising tax rates and so on, but it is making sure that people who have an income, that they are paying their fair share."

The lady in the back of the room, she said, "I don't mind paying even more taxes. I just want to make sure that everybody else is paying their fair share." And that is what we are trying to do here. Thank you for helping with that.

The CHAIRMAN. We are going to move on, but don't think you are really retiring. We are going to call on you for counsel.

Senator Grassley?

Senator GRASSLEY. Yes. You know that I spend a lot of time listening to whistleblowers throughout the bureaucracy, so let me speak about it. I know on July 21, 2023, IRS Supervisory Special Agent Gary Shapley emailed you, asking that you direct senior IRS leadership to stop retaliating against him.

On May the 18th last year, IRS Special Agent Joseph Ziegler emailed you to disclose his concerns about the IRS handling of a case that he was working on, and I had an opportunity to talk to him. So I know that they have asked to meet with you. What they want to discuss with you—I assume they want to tell you what is wrong with the handling of certain cases, and I think you at the top of the IRS would want to listen to them.

So, I am not going to ask you a question, but I am going to do now what I told them I would do. I was going to ask you to meet with the two of them and just listen to them. Whether you take action or not is up to you, but I think you ought to at least listen to them. I think whistleblowers throughout government are some of the most patriotic people I know, and I would ask you to do that.

Now I want to go to my first question. The IRS whistleblower program, which you know I was involved in getting enacted, has brought $6 billion into the Federal Government. It has been a pretty effective and efficient program, but we have this problem of the average wait time for people to get their case closed getting longer,

and it is now up to 10 years. The long average wait time is in part due to the IRS policy against paying partial awards.

Under this policy, the IRS will wait until all the years of claims are completed to pay anything whatsoever. Effectively, the IRS has created barriers to pay awards on its own that are not in the whistleblower statute passed by Congress. So you need to examine the unnecessary policy in the IRS revenue manual and work to allow partial awards to be paid to whistleblowers as quickly as possible. Could you do that?

Commissioner WERFEL. Senator, I am glad you asked the question. Between the question that Senator Crapo asked on identity theft backlogs and your question on the backlog on our whistleblower claims, you are pointing to two very high priorities as we move forward.

As I said in my opening statement, we have had a good filing season, but we have a lot more work to do, and these are two areas. I will commit to you—that is an interesting recommendation on partial payments and the way we can potentially accelerate how whistleblowers who are providing such valuable information to us get their fair share of the money that they saved for the American taxpayer.

So, we will look into that, and I will get back to you. Also, since I did not get an opportunity, Senator Crapo, I will get back to you on identity theft, another big priority and a big issue that we have to do better at.

Senator GRASSLEY. I am glad for whoever makes arrests for people who violate the law in IRS, because this one contractor is now serving 5 years for disclosing information. But I kind of wonder how an activist like him who wants to be contracted, who presumably got a job for the sole purpose of making public information about taxpayers—in this case, I guess he was after Trump's tax returns. How was an activist with plans to steal taxpayer information able to get hired and gain access to taxpayer information, and what action has the IRS taken to ensure an active employee or a contractor is never again able to access and share sensitive taxpayer information?

Commissioner WERFEL. Thank you for the question. Protecting taxpayer information from unauthorized access is an absolutely solemn responsibility to the IRS. The individual you referenced betrayed the trust of the IRS and the American people. It is a betrayal that cannot be tolerated, and based on what played out in court, it is not being tolerated, as this bad actor was brought to justice and will be serving a 5-year term in prison.

From my first day on the job back in March 2023, it was a top priority to strengthen the data security at the IRS, and we have taken numerous steps, working with TIGTA, to make sure that we have their to-do list, along with our to-do list: fewer users, more robust encryption, stronger oversight, better access logs, less removable media, tighter email controls, new printer controls.

All of this is ongoing and being put in place, to make sure that this type of unauthorized access by a contractor—in this case it was a contractor—or an IRS employee, can never happen again. There is always going to be that risk. What you try to do is narrow the risk to as small as it possibly can be. Insider threats and unau-

thorized access from insider threats—they are impossible to get rid of completely. But I am committed to reducing the probability to as small as it can be by putting in the sweat equity to close all those gaps.

The CHAIRMAN. Commissioner, I am Senator Grassley's partner in the whistleblower effort; have been for years. I very much support the fact that you are going to make those issues about whistleblowers that Senator Grassley mentioned a priority going forward. I will be working with our colleague from Iowa.

Senator Bennet?

Senator BENNET. Thank you, Mr. Chairman; I appreciate it. And, Commissioner Werfel, thank you for being here. I am considering taking a political risk this morning, which is to use the words "good news" and "the IRS" in the same sentence.

But I think certainly, I really want to call out, at a moment when there is a lack of confidence among the American people in our governing institutions, and particularly in the deployment of technology by government agencies—I am going through that misery myself, as the American people are, with the Department of Education, which has failed to do the FAFSA form, a form that Lamar Alexander and I worked for years and years and years to try to improve.

Now the American people are having to struggle with the absolute disaster that that has become, in terms of implementation. I have to say it appears to me that the IRS's Direct File effort may be a model of government technology implementation. That certainly has been the experience of people in Colorado.

I know that there are around 100,000 Americans who have used this to file their returns. I hope many more States are going to have the chance to participate going forward. You know, there are a lot of Coloradans who have interest in using this tool going forward.

So, I just wonder if you could talk a little bit about how you were able to successfully deploy this, Commissioner, and what do you think made the Direct File effort successful that we could learn from in other technological implementations across the Federal Government?

And I apologize for that sounding like such a ridiculously softball question, but it is such a rare occurrence that I thought it was important to give you the chance to talk about it.

Commissioner WERFEL. No, and I appreciate that. Look, I am proud of what we were able to accomplish this filing season. I am proud of the success of the Direct File pilot. I also acknowledge that there is a lot more work to do. As I look across the IRS, there are areas where we can learn from the success of Direct File and our own technology operations and our own management success, and I am going learn from it as well.

I think the first big decision we made was not to go too big, and to make sure that we focused on what I will call executional certainty. We could have tried to release Direct File to way more States and to have way more taxpayers eligible to use it in this first year.

But what we decided to do is, find that right first step, where we could test the interest, the demand, the user experience, the

cost, but not try to, you know, hit a home run at our first at-bat. So, we went out to 12 States, and based on the way we scoped it, 19 million people were eligible. We could have scoped it a lot bigger.

We waited until March 8th. Filing season started January 29th. We could have gotten excited and said, "Let's release this to everyone first day of filing season," to try to really kind of drive a bigger impact. But we wanted to take weeks working with a small number of volunteer taxpayers, to see how their experience was, to work out any bugs. Any time you do something for the first time, there are going to be mistakes.

So, lots of testing, lots of prioritizing, executional success versus the big splash. I think also, we worked across government. This was done not by IRS alone; we had a lot of help from people at GSA, in 18F, and we had a lot of help from the U.S. Digital Service in particular, who brought agile technology product expertise and worked side by side in a team room at IRS headquarters.

It was inspiring to visit that team room, see the energy and excitement, and see different parts of the government working together so well. But ultimately—and this is a little geeky—it was agile technology that was the eye-opener. There is a whole discipline about how you move more quickly to deliver incremental functionality, how you strip through bureaucracy and get decisions made more quickly, that you take calculated risks more regularly.

And the IRS is no different—Federal agencies tend to not be agile when they do technology. That is why you hear about projects taking 5, 6, 7 years. Here, by sizing this in an increment, an increment that had impact, we were able to be more agile, have executional certainty, and launch something that we can all learn from.

Where Direct File goes from here, we are not ready to announce that. But one thing is for sure: taxpayers had a positive experience with it, and we all learned a lot from this experience.

The CHAIRMAN. Thank you, and I thank my colleague. And I would just say to him, I do not think in the history of the Finance Committee we have ever heard anyone give an eloquent explanation of incremental functionality. So, we very much appreciate it.

Commissioner WERFEL. Had to start somewhere.

The CHAIRMAN. You did. You got the points on the board.

Senator Whitehouse?

Senator WHITEHOUSE. Thank you very much, Mr. Chairman, and thanks, Commissioner, for being here.

First of all, let me just echo what Senator Bennet said. I meet pretty regularly with my Taxpayer Advocate in Rhode Island, and she has seen her workload expedited so quickly as the caseload that she carries to help Rhode Island constituents has been able to move much more rapidly and successfully through the IRS in the wake of the funding.

So you have a fan who can show real results from the work you have done to simplify and speed things up at the IRS.

The topic I want to raise with you is one I have raised before, and that is the problem of 501(c)(3) and 501(c)(4) enforcement. My view is that when the Supreme Court performed its *Citizens United* decision, that unleashed enormous amounts of money into the polit-

ical system and made it, for the first time, a very significant and consequential thing to be able to hide who the donors were.

Once you have tens of millions of dollars to donate, it is a whole different game than if it is thousands of dollars. So they went straight to work, and the first area was the 501(c)(4)s. I will concede that the IRS did kind of a fumble of the way it handled that, but at the same time, the problem was real.

And when people started looking into the abuse of 501(c)(4)s, there was a massive right-wing pushback using what I call the "full outrage machine," and the next thing you know your predecessor was being threatened with impeachment. His assistant was being referred to the Department of Justice for criminal prosecution, and since then, literally billions of dollars have flowed through 501(c)(4)s.

There are at least two areas in which there seem to be a lot of ongoing violations. One is the planned cycling of money through 501(c)(4)s, where you get four related 501(c)(4)s sitting around the table, and the first one takes 50 percent of the money and sends it to the super PAC, and the second one takes 50 percent of the 50 percent and sends it to the super PAC, and the third takes 50 percent of the 25 percent and sends it to the super PAC.

By the time you are done with the fourth one, you've got more than 90 percent of the money going straight into politics, contrary to the rule of 50 percent, which I think was a sloppy rule to begin with.

But taking it as a given, this is a really cheesy end-around, and I do not see any effort at enforcing it.

The second is that now the state of the art in political influence is a 501(c)(3) and a 501(c)(4) that are virtually indistinguishable. And as best I can tell, there is no effort whatsoever to pierce the corporate veil or investigate whether a 501(c)(3) and a 501(c)(4) are legitimately staying in their lanes when they share the same staff, the same office, the same address, the same donors, the same boards, all of that.

So I would really urge you to take a look at this. It is the Wild West out there, and it is a Wild West of nonenforcement. I know that you guys took a hell of a beating, and I know that the Obama administration did not stand up for the organization back then.

But at some point, the sheriff has to take his boots off the table and put them on the ground and go out and clean up the town, and we badly need it cleaned up.

Commissioner WERFEL. Senator, I want to make sure we get to the right answers on an effective following of the appropriate rules for 501(c)(3)s and 501(c)(4)s. Look, between Fiscal Year 2020 and 2023, the IRS worked 100 unique cases under our political campaign intervention program. Is that enough? No. There is more work to be done.

When I describe what the Inflation Reduction Act funding enables us to do, it enables us to make investments to spot complexity and to address complexity. That complexity often happens in multinational corporations, offshore tax havens, all of that. But there is also complexity in the tax-exempt space as well.

The situation with tax-exempts, as you very clearly outlined, is fraud, with risk and delicate decisions that need to be made. Be-

cause if you—let's say there are 10 different paths for how you move forward and enforce. Eight of them you can step in a pothole and really mess it up.

So we have to be really, really cautious in terms of how we scale our enforcement efforts, so there is no sense ever that there is any politics in IRS operations, that we are doing things above board, nonpartisan, and we are tackling this issue in a way that is above any reproach.

Senator WHITEHOUSE. Well, if your goal here is not to enforce the law but to avoid reproach, then people who do not want you to enforce the law can use strategic reproach to try to keep you from enforcing the law.

Commissioner WERFEL. Well, we want to make sure that we are building trust with citizens. And so I am ready to roll up sleeves and work with you on how do we build off the 100 cases we have launched, ramp up our enforcement, but do it in a way—look, I am ready to take criticism. That is not my concern.

The issue is just making sure that, broadly, taxpayers believe that we are taking the right process, that we are doing things transparently, and that they can have confidence that there is effective oversight as well, to make sure that there is no risk or no perception of any politics in our operations.

I am absolutely committed to that, and willing of course to work with you on it.

Senator WHITEHOUSE. My time is now up. Thank you, Mr. Chairman.

The CHAIRMAN. Okay; let's see. Next would be Senator Cassidy and then Senator Warner.

Senator CASSIDY. Mr. Commissioner, thanks for coming in; I appreciate it.

When—maybe it was the first time we met, certainly the first hearing, I think I pulled out clippings from the Reagan administration talking about how the IRS was modernizing their computer systems, and they were about how it never happens.

Now, I have been looking at a lot of this, because you are not the only agency which, I mean, never accomplished it. I grant that there has been some success with the IRS, but I keep on getting the sense that we are having something custom-built for the IRS.

Now, I have done a little research, and in 1994 there was the Federal Acquisition Streamlining Act, a law that prohibits government from starting bloat-filled projects if an off-the-shelf solution is available. I am quoting from the article I found.

Now, there are off-the-shelf solutions right now to capture fraud, to answer people during tax season. AI can do that. I read a statistic that only 29 percent of phone calls were actually answered in the 2023 tax season. There is off-the-shelf stuff that can do this, with minor modification.

But if you said it has to be done within 6 weeks or 6 months, boom, they would hit it. Is the IRS doing any of that?

Commissioner WERFEL. Well, yes. It is mixed. Where we see an opportunity to use an off-the-shelf solution, we need to seize it, and there are instances where we will use off-the-shelf——

Senator CASSIDY. Now, let me stop you. In all due respect, when you say "when we see it," by what means are you viewing?

Commissioner WERFEL. Well, we have looked—we try to understand, for example, where industry is using something similar. Let me give you an example. So, if we have an opportunity to use voice recognition, so when someone asks, calls in, they can talk to a computer and say, "Can you tell me about my refund, how many more days until I get it?", that the computer understands them. They do not have to wait for a phone call and the computer says, "Your refund will be issued to you in 8 days from now," or whatever. That is something where we have an opportunity; why reinvent the wheel?

But when you have something that is very specifically wired to having to accommodate the complexity of the tax system, like someone filing an amended return—right now, the way we process amended returns is not automated, and it is a priority for us to automate it.

Senator CASSIDY. But let me ask: have you gone to industry and asked them if there is an off-the-shelf solution? I say this because Operation Warp Speed was warp speed because we did a lot of off-the-shelf stuff that people formerly thought had to be custom designed.

When I read about AI in Ukraine or in Israel, it is kind of not entirely off-the-shelf, but it can be adapted on the fly. So I say that we are really good at software. So, who is making the call that this is so specific that it cannot have an off-the-shelf solution? Are you actually soliciting to see if there is——

Commissioner WERFEL. I agree. Look, I am in agreement with you. I agree that off-the-shelf is the way to go, and that in general, government agencies tend to try to customize when they should not.

And so, I have the same guiding principle that you do, that why modify it? You should modify your business processes to meet the commercial off-the-shelf solution. It is a better approach, and we can certainly be more aggressive in that space.

I do not have—what I would like to do is come back, if you are willing, with some inventory discussions around where we are off-the-shelf, where we are not, and maybe we can look at the gray area and see if we can move more to off-the-shelf.

Senator CASSIDY. And can I ask you this, because my staffer is right behind me, he is taking notes. If you said, okay, listen, this is what we are going to talk about. We are going to meet ideally within 3 or 4 weeks, and this is what we are going to talk about. Give us a week just to call three or four different big software companies and ask, could you address this with off-the-shelf?

Because I think there are capabilities out there that you and I are not familiar with, and that frankly a government agency may not be familiar with, even at its best.

Commissioner WERFEL. I agree.

Senator CASSIDY. So, if we could have you both schedule that follow-up and then get a little bit of advance notice, and give us time to kind of scout out——

Commissioner WERFEL. Senator, will do.

Senator CASSIDY [continuing]. That would be fantastic. I appreciate that. Oh, this is going to make my day.

Let me give you one more thing. The IRS has decided to delay implementing the change to the Form 1099–K reporting threshold for transactions on third-party payment platforms such as Venmo and PayPal. That was enacted under the American Rescue Plan in 2021, and it moved the threshold from $20,000 to $200 to help taxpayers transition. The IRS will keep the $20,000 and $200 transactions threshold for 2023, and phase it in in 2024.

So, can you discuss what the IRS's—now by the way, Senator Brown and I, bipartisan, we put in the Red Tape Reduction Act, that would raise the threshold to $10,000 to protect small businesses. So, can you discuss the IRS authority to delay the implemented laws, and can you explain how the IRS arrived at the $5,000 threshold for Tax Year 2024?

Commissioner WERFEL. Yes, I can do both. I will do it quickly. First, we have in law a responsibility to implement all tax laws in a way that protects taxpayers' rights, and a set of Taxpayer Bill of Rights is written out in the law.

As a result, there have been times in IRS history where in order to protect taxpayer rights, we have had to ramp implementation of a law if it was going to be either overly burdensome to them or potentially overtax them beyond what they actually owed.

This particular law created both risks. So we felt, on balance, in order to meet our statutory responsibility to implement the code consistent with the Taxpayer Bill of Rights, this was one case, and we have done it before where we have ramped implementation of a law.

Five thousand dollars came from work with stakeholders. We worked with the major companies that are third-party pay platforms. They were concerned about their customers receiving a slew of 1099s that they would not know what to do with and a lot of confusion about how you would, for example, calculate a basis of some kind of good that you sold on one of these platforms.

So many questions came in, and we asked them a lot of questions like, what is the right way to ramp this, consistent with protecting taxpayers from confusion, burden, and being overtaxed? They said, "Give us time," and they helped identify $5,000 as a threshold that would allow them to deal with a smaller number of transactions and customers, but yet get a lot of receipts back to the U.S. Government.

The CHAIRMAN. As important as the Cassidy issue is, we have to move on.

The next three will be Warner, Lankford, and Johnson.

Senator WARNER. Well, thank you. Thank you, Mr. Chairman.

I wanted to quickly add, if you are going to get Senator Cassidy this information about not recreating the whole ball of wax on software programs and updates on computers, I would like to see it as well. I 100-percent agree with Bill, you know.

It just seems we always have to customize everything in government and usually end up with products that are frankly not as good as off-the-shelf. I would also add, while there are enormous challenges around AI, in this area there is a great deal of upside. So I hope whatever information you get to Senator Cassidy, you get to me as well.

I am a little surprised—and, Commissioner, it is great to see you. Thank you for—I remember when you first got nominated for this and, you know, was this really the way you wanted to spend this part of your life? I am glad you are; I am glad you are doing it. I think you are getting results.

I am a little surprised that we have gone through a number of questions and you have not been asked what I would have thought would have been one of the first questions, because even some of my Republican colleagues who do not like all the money going to IRS, I think most of them would agree that better enforcement will help grapple with the tax gap. And the most recent estimate on the tax gap for 2021, I think, put it at about $688 billion.

So we would not have to raise taxes if we could have that full payment. There have been some estimates that we could actually get a savings with the investments we have been making of $800 billion over a 10-year span, by 2034.

There has been some testimony that, while you and the Treasury Secretary indicated you are looking at high-net-worth individuals in terms of enforcement, I think there is some reference said that there is upwards of $500,000 in additional revenue from each investigation you garner.

Can you give us some sense—for those of us who pushed this kind of record investment in the IRA in your organization—what do we look like in terms of how we are making progress in closing this tax gap, and what kind of metrics on a regular basis could we see?

Commissioner WERFEL. Yes. Thank you for the question. First, I would start by saying that the first gap that we have been able to close is the services gap, and we put the Inflation Reduction Act money to use to make sure that we had the right number of people on the phone——

Senator WARNER. Yes, and we have gone from 30-minute waits to 3-minute waits.

Commissioner WERFEL. Yes, exactly; so that is first.

Second, we have made a commitment to use Inflation Reduction Act funds and enforcement exclusively on large, complex, high-wealth filers, and we are just getting started.

We have announced initiatives for wealthy individuals who have not filed, about 125,000 of them. We have announced initiatives to collect delinquencies from millionaires and billionaires who owe back taxes. We have announced efforts to crack down on something called transfer pricing, where multinational corporations shield profit and income in the U.S. and move it to a different tax jurisdiction.

We have announced efforts on cracking down on the largest and most complex partnerships, who are particularly sophisticated at times in shielding their income, and using AI to spot that complexity. We believe that the efforts that we are undertaking under the Inflation Reduction Act, when they are all totaled—and we issued a report on this a few months ago—could result in nearly $700 billion in return. And we are——

Senator WARNER. And that $700 billion is over 10 years?

Commissioner WERFEL. Yes, yes. We were debating earlier the President's 2025 budget, and concerns were raised about the $104

billion that we have asked for in the out-years, starting in 2026 and beyond. I described needing that money to make sure that we are sustaining what we are able to achieve this year and beyond, as the tax system and the economy continue to grow in complexity.

That $104 billion that we are asking for would also return about $341 billion over 10 years in additional revenue.

Senator WARNER. Beyond the $700 billion that you have already mentioned?

Commissioner WERFEL. No, that would be included in it. That is why it is so important. That is why it is such an interesting debate on IRS funding, because there are two things at play. One, it is making sure that we can help taxpayers who need it. Taxpayers have questions. Filing your taxes can be stressful. The tax system is complicated, and it is heartbreaking to us as IRS employees if we cannot answer the call.

So having enough funding to be able to have the right staff size and the right customer service, but also, it is absolutely essential to the government's bottom line that the IRS is closing that tax tap and collecting those balances due.

Senator WARNER. I agree.

Let me just quickly, because I know that my time is running out. One area where I still get a lot of concerns with this improved customer service is, families who have a loved one who has died, how you deal with the deceased processing. Are there some plans on how we can improve that part of the service?

Commissioner WERFEL. Yes. There are a couple of different areas where we hear from taxpayers that it is complicated and they are not getting direct and clear service. Identity theft victims—we have done a fairly good job preventing identity theft, working with partners.

But on the back end, once you have unfortunately been victimized, we are too slow, and we need to get quicker. And you raise another question in terms of families that are dealing with deceased relatives and resolving—it gets confusing.

Senator WARNER. I hope you can come back——

Commissioner WERFEL. Yes, absolutely.

Senator WARNER. Our time is up, but I hope you will come back with a plan on how you are going to improve that service.

Commissioner WERFEL. We will.

Senator WARNER. That is one of the areas we still have a lot of concerns about.

Commissioner WERFEL. We will.

The CHAIRMAN. Thank you, Senator Warner.

Senator Lankford?

Senator LANKFORD. Mr. Chairman, thank you. Good to see you again. Thanks for the work you continue to do. It is an incredibly difficult job, and obviously this week, with all of the filings and everything else that goes on, I appreciate you being here on this.

Senator Cassidy was just asking about the Venmo requirements that my Democratic colleagues added in the Inflation Reduction Act, that there would be additional new reporting on people that actually use Venmo, and that there would be new filing requirements and such that would come from that.

You expressed that there is a flexibility of that interpretation, based on other statutes on this. This is part of the challenge that we are dealing with right now, is the flexibility side of things, and trying to determine what is something that can be counted on and how that is actually interpreted and where it goes.

Sitting at that exact same table just a few weeks ago was a business leader from the Huntsman Corporation, who was talking about how they were doing some chemical manufacturing for EV batteries, but for the tax credit piece, the 30D clean vehicle tax credit, the Foreign Entity of Concern restriction that was out there dealing with that was waived for China by Treasury and by IRS, so that that company that was an American company no longer was competitive, because the Chinese company was now competitive, even though the statute itself says that that is not allowed.

There was a waiver that was given to a Chinese company that directly undercut an American company on that. So the predictability of this becomes a big issue. Where I am headed on this is, this administration took out what is called the OIRA review for the IRS for new regulations.

Obviously, the previous administration had an additional review. This administration took that out. My question is, why is it a bad thing for the IRS to be able to have OIRA review for regulations they are putting in, when you have expressed the flexibility that you have to be able to do that, but every other entity needs to have OIRA review, to be able to have some kind of review under the Administrative Procedures Act?

Commissioner WERFEL. That is a great question. Ironically, I started my career at the Office of Information and Regulatory Affairs at OMB, and I am a big proponent of notice and comment rulemaking. I am always telling my team, if there is an opportunity for us to go out for public comment, whether through formal channels like the Administrative Procedures Act or any way, so that we can telegraph where we are going, so much the better.

Going back to the 1099–K, that is what we tried to do in terms of having public meetings and open forums and webinars, to try to hear the concerns and reconcile them, and to make sure that we were accessible. I know that we continue to do notice and comment rulemaking. I know that, for example, on the recent regulations on cryptocurrency, we got 40,000 comments on it, and so we continue to have that process.

I will have to get back to you on kind of the nuances of how we continue to work with OMB and OIRA. It is a different path than other agencies, but it is not a no path. We continue to feel accountable, to make sure that we are leveraging notice and comment as often as we can.

Senator LANKFORD. What I do not want to have is, when we do not want to go through review, we do not have to; when we do want to go through review, we do. I do not want to have a situation like that, because then it is unpredictable again, and we are back again to the flexibility issues.

This committee has talked about this often dealing with the Pillar 1/Pillar 2 conversation that is out there. Pillar 2 is expected to be able to take away about $120 billion from American taxpayers. The Finance Committee in particular has asked the Treas-

ury to say, "Are you really going to go around this committee and cut out $120 billion," and we are still getting this push and pull back and forth with Treasury on it. So we are interested in what is predictable and what is consistent.

If I could move on to a couple of other quick things on it. One is, as you and I have talked about before, I have worked a lot on charitable giving. This is an issue I think is important that we incentivize as American in our tax code. It is something that will come up in our conversation next year when we are dealing with a lot of tax policy issues. But it is an area where we do need to get some insight from the IRS on what has happened in charitable giving.

It is our understanding that after we stopped incentivizing charitable giving through our tax code, we had a dramatic drop in charitable giving across the country, which hurts our nonprofits, which hurts that big safety net. We want to be able to get more information from you on that. We will follow up on that in the days ahead.

We are also working a lot on the Tax Cuts and Jobs Act. Obviously, that is coming up next year for bonus depreciation. We are in a lot of debate right now on it. But it was interesting to me on this that we have seen such conservative bastions as Harvard, Princeton, University of Chicago recently put out a study saying that based on some of the business tax pieces, that there was a 20-percent increase in investment, and also an increase in taxes that are actually coming in.

My question is, there is this conversation that is happening out there about trying to raise business taxes again. Based on this study that I am sure you have seen and others that are out there, are we continuing to see more investment in business now than what we saw years ago?

Commissioner WERFEL. Senator, that is a question that I need to get back to you on, in particular because it is more in the domain of Treasury and tax policy, and I do not want to get out in front of them. But I will coordinate with my Treasury colleagues and get back to you on the answer to that question.

Senator LANKFORD. Okay; thank you.

The CHAIRMAN. The time of the gentleman has expired.

We are just going to keep going, because I know the Commissioner has got a schedule. Senator Cardin is going to help. I am going to run and go vote, but we will just keep going. Next will be, in order of appearance, Senator Johnson, Senator Hassan, and Senator Tillis. But we will just keep going.

Senator Johnson, you are next. Senator Cardin will act as chair, and I will be right back.

Senator JOHNSON. Thank you, Mr. Chairman.

Mr. Commissioner, Senator Grassley asked you to meet with whistleblowers Shapley and Ziegler. I do not think he asked for a commitment, so I will ask you to commit. Will you commit to meeting with those two whistleblowers?

Commissioner WERFEL. Senator, what I commit to is relying on the Inspector General to run the process, to make sure that the rights of those whistleblowers are protected. So, I will consult. I am not going to jump in front of the Inspector General.

Senator JOHNSON. Okay, so your answer is "no."

Last year at this hearing, there were some pretty bizarre things going on that seem like a politically motivated unannounced home visit. We wrote you about that. You claimed section 6103, which I understand.

But since then, we have also seen IRS agents using a fake alias, deceptive tactics to enter someone's home. We have seen the IRS attorney backdating documents. My question is, have you investigated these situations? Has anybody been held accountable?

I know you ended unannounced home visits by and large, but have you investigated these? Has anybody been held accountable, anybody disciplined for these bizarre actions?

Commissioner WERFEL. Yes. In any situation where the IRS makes a mistake or acts inappropriately, or an IRS employee, we have to acknowledge it, and we did in the cases that you are describing. We have to then fix the issue, fix the process, train, put in new controls, and then, as you mentioned, take appropriate personnel actions.

I have instructed the team in all of these cases to do all of those things.

Senator JOHNSON. Okay; good. I appreciate that.

In your testimony, you said "as the tax system continues to grow." You obviously mentioned the fact that our economy is growing. We have more taxpayers, I understand that. But you also mentioned complexity. Later on, you said "the tax system is complex."

Commissioner WERFEL. Yes.

Senator JOHNSON. You know, I have noticed, certainly in the Inflation Reduction Act, the solution was not to address complexity, but it was to throw more money at the problem. You know, from my standpoint I think we could do so much to help solve so many problems if we would address the complexity and try to start simplifying the tax system.

So that is my first question: is that something the IRS, this team, looks at in terms of a project of what would be the best way; what would be the most effective simplifications we could direct toward the tax system?

I will also ask you, is it more complexity on the individual side versus the business side? I mean, can you give me some sort of feel——

Commissioner WERFEL. Yes. It is definitely more complex on the business side.

Senator JOHNSON. So let me just stop you right there.

Commissioner WERFEL. Yes, please.

Senator JOHNSON. What is interesting about that is, you know, business taxes, C corps, were about 16 percent last year of total revenue. If that is all of the complexity—now again, I do not have the numbers of pass-throughs as it relates to the individual.

But we do not raise anywhere near the amount of revenue if that is the more complex side. So that is just begging for simplification, right?

Commissioner WERFEL. Yes. Well, we always advocate where we can, for the ability to administer the tax code effectively, and any time we look at a set of laws and in reality, what is going on out there in the economy, we are always going to say, here is where we can administer more easily versus not.

Ultimately, it is up to this committee, working with Ways and Means and my leadership over at the Treasury Department, to decide how to change those laws. But yes, the complexity—it is not just the complexity in the tax laws, but that feeds different types of corporate and large partnership behavior. We are seeing really, really more complicated arrangements, the movement of money across international jurisdictions, movement of subsidiaries. Very complicated processes——

Senator JOHNSON. And when I am talking about all the problems being solved by simplifying the tax code, again, not economic behavior driven by a complex tax system. So again, I am also interested in the off-the-shelf solutions. Let me kind of let the entire committee know that.

But again, I would really encourage the IRS, with your expertise in terms of what you are having to deal with in terms of complexity, to report back to this committee, here is the low-hanging fruit. This could really help us out a lot if we could simplify this without really impacting revenue, okay?

Again, I think we could do so much in terms of closing the tax gap. Well, part of the tax gap is just complexity and people avoiding taxes, not necessarily evading them. But again, if you make the tax code complex, it is easier; there is a lot, a lot more avoidance. So again, I would—is that something you have done? Is that something you could take a look at?

Commissioner WERFEL. We generally do it on a case-by-case basis, like earlier in discussion with Chairman Wyden on the ERC, the law associated with the Employee Retention Credit. The fact that you can still file for an ERC into 2025, when the period of eligibility was between 2020 and 2021, that creates a lot of extra work for the IRS and a lot of extra complexity that drives our costs up, and this is why we need more funding.

So, yes, on a case-by-case, on an inventory basis, like you are describing, I think it is a great question, and I will go back and talk to the team about that.

Senator JOHNSON. I would appreciate it, because if you can find the low-hanging fruit that is just completely nonpartisan, say, "This is so obvious, fix this," I would like to think this committee and this Congress could fix it for you.

Thank you.

Senator CARDIN [presiding]. Senator Hassan is recognized.

Senator HASSAN. Well, thank you very much, Senator Cardin, and I want to thank you and Chair Wyden and Ranking Member Crapo for this hearing. Commissioner, thank you for being here, and thank the people you work with for all their fine work as well.

At the IRS, modern IT systems are critical for improving services provided to taxpayers. In past years, I have heard again and again from my constituents about delays with getting their refunds and other taxpayer services. IT issues have obviously contributed to these delays.

For example, IRS's difficulty in processing paper tax returns has led to significant issues for taxpayers, an issue I know that IRS is taking steps to address. What are you doing going forward to modernize IRS's IT systems so that families do not experience delays in getting their refunds and other taxpayer services?

Commissioner WERFEL. Well, on this, I have some good news, which is the main system at the IRS that is the engine for all individual returns is on the cusp of finally being turned into a modern solution. That is coming after this filing season. We will have more on that.

What we will be able to describe to you and the American people and your constituents is how that will impact them, with more real-time information, faster processing. So there is some good news coming on our technology modernization effort, in particular how it impacts individuals and families.

Senator HASSAN. That is terrific. Thank you, and I look forward to hearing more about that. It is something that we hear about literally daily in our constituent service team.

Different topic: cyber-criminals often quickly convert stolen funds into cryptocurrency, making it nearly impossible for law enforcement to recover the funds. This happened to the town of Peterborough, NH in 2021, when criminals stole $2.3 million and then converted it to cryptocurrency.

Following this cyberattack, I pressed your predecessor, Commissioner Rettig, on how the IRS can help combat this kind of cybercrime. He sent me a letter recommending stronger "know your customer" requirements for cryptocurrency exchanges.

Commissioner, in your view, how could strengthening these requirements help recover stolen funds after a cyberattack?

Commissioner WERFEL. Yes. I agree that there is a chain of events that occurs, and people along that chain of events need to know what is going on. Outside of crypto, for example, suspicious activity reports by financial institutions or brokers are a critical unlock for law enforcement to understand where these activities are.

That is not mature yet in the crypto space and with the crypto brokerages. So I completely agree, that is a place to focus.

Senator HASSAN. Okay; thank you.

And last question: last year I led a bipartisan push with Senators Wyden, Grassley, and Lankford for the IRS to address possible tax scams fueled by artificial intelligence. One concern that we raised is that scammers can target seniors and small businesses with convincing AI-generated emails that claim to be from the IRS.

What trends in possible AI-generated tax scams has the IRS seen so far this filing season?

Commissioner WERFEL. Well, first of all, we have seen an increase across the board, and our private-sector partners, tax preparers, are also reporting an increase. There is a lot of IRS impersonation, a lot of very sophisticated behavioral science to understand what, for example, will convince an elderly person to pull out their credit card and pay a fake tax debt.

We have to solve this through a combination of things. Awareness campaigns can help. One thing, Senator—I participated in an international tax summit, asked my fellow commissioners around the world this same question. One of the big fixes that is out there that has helped is putting into an individual's online tax account the basic flag of whether the IRS or the tax authority is trying to reach you.

Some of our peer nations have really disrupted AI impersonation by encouraging their citizenry to come to their tax account and see whether it is us that is really trying to reach you. We have plans for next filing season to include such a flag in people's online accounts.

Senator HASSAN. Okay. That is very helpful, because in response to our letter—I think this is along the same lines—you said that the IRS was adding online tools that would allow taxpayers to verify that.

Commissioner WERFEL. Yes.

Senator HASSAN. So this is what you are really talking about.

Commissioner WERFEL. Yes, but we also have to educate people. They have to sign up for their online accounts and not panic when someone calls claiming to be the IRS.

Senator HASSAN. Okay. And so, where is the IRS in getting these online tools up and running to protect taxpayers against these scams?

Commissioner WERFEL. This is a big priority for next filing season. It is a combination of that flagging, but also kind of a one-stop shop for taxpayers, all the notices that you may have gotten. Many taxpayers will have none.

Senator HASSAN. Yes.

Commissioner WERFEL. I mean, this is what is really interesting. It is like you get a text, you get an email, you get a phone call, and your neighbors got the same one, your work colleagues. The vast, vast majority of taxpayers are not going to hear from us, so it is really about educating.

But we are working to make sure that by next filing season, we have these tools in place. In the meantime, we are doubling down on awareness campaigns.

Senator HASSAN. Thank you very much.

Thank you, Mr. Chairman.

Senator CARDIN. Senator Tillis is recognized.

Senator TILLIS. Thank you, Mr. Chairman. Commissioner Werfel, would you introduce the lady who is sitting behind you, who has been working for the IRS for 53 years?

Commissioner WERFEL. Diane Grant.

Senator TILLIS. Thank you for your decades of service. And she is also from Tennessee, Senator Blackburn. I think we mentioned that earlier.

Commissioner Werfel, quickly—I do not expect you to have an answer for it. If you do, it would not surprise me, but I would not expect it. Can you give me to date the fully burdened cost of the free filing system implementation?

Commissioner WERFEL. I would not want to do that, Senator, only because the pilot is still running as I am sitting here. So, it would be premature, but within days, by the end of April——

Senator TILLIS. I also—I do not want just the IRS internal cost. I want fully burdened——

Commissioner WERFEL. Understood, yes.

Senator TILLIS [continuing]. Other actors, so that we really understand the nature of the investment.

A quick question on that as the pilot is moving forward. I think that you all are implementing an API that automatically loads

AGI, adjusted gross income, something the industry and something the Free Alliance asked for for years.

What is the posture of the agency in providing that API to authenticated third parties?

Commissioner WERFEL. I will look into that. I mean, we were talking to taxpayers who are using the Direct File solution, and there was some confusion around how to get to your AGI amount, which is a key moment in your tax filing process, from the previous year. Absolutely willing to talk.

Those partners, our partners who provide the commercial software, we work very closely with them.

Senator TILLIS. Yes, I agree; they are great.

Commissioner WERFEL. Yes. They are terrific.

Senator TILLIS. If it is a tool that is going to be available for free filing, we can deal with whatever privacy security concerns that there may be. But it does not seem fair or appropriate to have that additional step.

Commissioner WERFEL. We will look into it, sir.

Senator TILLIS. I for one hope that this pilot, this thing you are working on right now, at some point you just decide it is not worth it, because the private-sector options are so much better. It becomes a distraction. That is my personal bias. I know you are—I cannot believe——

I was trying to figure out a way that I could ask this question that would not get you in hot water. But I admire your background, that is why I supported your confirmation, and so far, I am happy with what I have seen. But I just cannot imagine a project of this scale, if you were coming in and trying to fix all the things that need to be addressed or modernized in the IRS, that you would have been pounding the table saying, "This has to be one of my top five initiatives in my tenure."

I mean, can you at least stipulate that while this may be nice, it is not one of the most important things that the IRS should be dealing with right now?

Commissioner WERFEL. It is such a difficult question to answer, because there is so much that goes into it. I will say that as we try to hear from taxpayers—and it is not an exact science, right, in terms of what you are hearing from different constituents—there are loud voices out there who want this——

Senator TILLIS. Again, I am not going to get you in hot water, but it just defies logic. I worked in the consulting profession for years, implemented a lot of financial system platforms. I never went into a client and said, "You know what? We should just build it from the ground up. We should do this differently."

So what is disturbing to me, or disappointing to me, is that I have not seen a fully executed strategy on exhausting all the possibilities for free filing, for for-pay filing, for being able to file for free on some of the for-pay platforms.

It just seems to me that we could have found another way to fix the problem. And so, instead of just using a fly swatter to address some of the problems that some of the IRS filers were having, we decided to create a thermonuclear detonation device to do the same thing.

Commissioner WERFEL. Can I share with you——

Senator TILLIS. It's like a $100 saddle on a $10 horse.

Commissioner WERFEL. I will share with you, one benefit from all of this is that we saw a substantial increase in the number of people who filed for free electronically across all platforms this year.

Senator TILLIS. Sure.

Commissioner WERFEL. Two million more people filed electronically for free.

Senator TILLIS. I agree, and so——

Commissioner WERFEL [continuing]. Because there was so much attention on it.

Senator TILLIS. And so, to follow up, if we had spent just a fraction of the money on this platform that we are putting in place, that we are going to have to care and feed and then modernize 10 years from now, and so on and so forth. it just seems like there would have been a better way to achieve the goal. If the goal was to provide cost-effective or no-cost filing options, there were other options out there. So I know you are doing your job.

Tax gap: you know, I hear people—and I am just going to make a comment and not even ask you to respond. I think your goal right now, if you are a successful IRS Commissioner, you are going to succeed in not having the tax gap grow. You are not going to dramatically reduce the tax gap, because we can get into a variety of reasons why it exists, at the high end of the spectrum or the low end of the spectrum.

But is it fair to say that those of us up here who may see, I don't know, let us say $500 billion, whatever the latest number is, of uncollected taxes——

Commissioner WERFEL. Six hundred sixteen billion.

Senator TILLIS. Is it fair to say that people up here who think that is a smoking good pay-for are probably not being realistic about your ability to just zero out that tax gap?

Commissioner WERFEL. It is a difficult enterprise to undertake. If you will notice, when we——

Senator TILLIS. Okay. I will go ahead and roll, because I want to be respectful of other folks' time. But I want to get back with you on progress with the tax gap. Thank you.

The CHAIRMAN. I thank my colleague, and it is an important issue.

The next two in order will be Senators Warren and Blackburn, and I have just got to tell colleagues that we have to keep everybody to 5 minutes at this point. We are just never going to get done.

Senator Warren?

Senator WARREN. Thank you, Mr. Chairman.

So, it was not long ago that the one-two punch of the pandemic and nearly 20 years of underfunding brought the IRS to its knees. We all remember the phones that were not answered, the stacks of unprocessed returns sitting in boxes.

But Democrats secured billions of dollars in long-term funding for the IRS so that you could do your jobs, and the turnaround has been truly remarkable. Yesterday was the tax filing deadline, and I want to congratulate you, Commissioner Werfel, and all of the hardworking folks at the IRS for a smooth tax filing season.

So this year, the IRS launched a pilot program called Direct File, a first-of-its-kind option for Americans in 12 States, to be able to file their taxes online directly with the IRS. It is easy, and it is free. And that means, instead of the $150 on average and 9 hours that taxpayers typically spend for the privilege of filing their taxes, they can do it for free with the IRS.

So, Commissioner Werfel, I am sure your team is still going through all of the data from the filing season. But what is the feedback that you have seen so far on Direct File?

Commissioner WERFEL. It has been tremendously positive. The results of the pilot have been super-encouraging for a couple of different reasons. One, the product worked. Second, our partnership with the States like Massachusetts, the State's product that we handed it off to—because once you do your Federal taxes on Direct File, if you have a State income tax, then you have to do the handshake like we did with the State of Massachusetts and the State of New York and others—that worked as well.

Taxpayers told us in almost, almost unanimity that it was easy to use, fast, secure, and of course free, which was the bottom line that people wanted to emphasize. So very, very encouraging results. But as we sit here—and you know this better than anyone—Massachusetts is still filing, and the pilot is not done.

I know there are a lot of people who want to know, okay, what was the cost, what are the final numbers?

Senator WARREN. So we are not there yet.

Commissioner WERFEL. We are days away.

Senator WARREN. I just want to—that's right, days away. But I do want to start with the fact that Direct File is getting five star reviews, I take it.

Commissioner WERFEL. It is.

Senator WARREN. So, taxpayers are raving. The phrase I have heard is "so darn easy" that they filed on their lunch break. And best of all, as you say, they did not have to worry about fees, did not worry about ads, did not have to worry about upsells, the way that giant tax prep companies like TurboTax make their profits.

So of course, these tax prep companies are kicking and screaming and trying to shut the program down, and their lobbyist friends claim that it is somehow illegal for the IRS to provide a 21st-century online tax form. This argument is laughable. The IRS, like every other government agency, is supposed to modernize and upgrade services over time.

But let us dig in a little more. Commissioner Werfel, decades ago the IRS mailed out tax filing forms, and the post office stocked the paper forms, and that was it. But in 1986, the IRS piloted electronic filing. Back then, that meant plugging phones into modems, transferring data by tapes. It was real cutting-edge stuff in 1986.

To your knowledge, did anyone suggest that the IRS did not have legal authority to do that?

Commissioner WERFEL. No.

Senator WARREN. All right. Decades ago, a tax refund was a paper check. But in 1987, the IRS expanded the pilot and added electronic direct deposit, to put refunds directly into people's bank accounts. Did anyone, to your knowledge, say that the IRS could

not do that because direct deposit was not specifically referenced in the statute?

Commissioner WERFEL. No.

Senator WARREN. And in 2008, the IRS created PDF forms that taxpayers online could fill out and file electronically. Did anyone suggest that service was somehow beyond the reach of the IRS?

Commissioner WERFEL. No.

Senator WARREN. You know, there was a time when the only way to ask the IRS a question was to mail them a letter or to show up in person. But at some point, the IRS started using the phone, and then email and, whoa, be still my beating heart, the IRS now uses texts.

In other words, the IRS is doing what all of government should be doing: modernizing and making it work better for ordinary people. There is a big return on the investment here. The Economic Security Project studied the full costs and benefits of a full-fledged Direct File program and determined that nationwide, Direct File will save taxpayers $23 billion a year, including tax prep fees that they will not have to pay and tax refunds that people currently miss out on.

I did the math. That is about $100 to individual taxpayers for every $1 invested in Direct File. It is a great investment. Thank you for the program.

Thank you, Mr. Chairman.

The CHAIRMAN. As much as I agree with the Senator from Massachusetts, we have to move on.

Senator Blackburn?

Senator BLACKBURN. Thank you, Mr. Chairman. And, Commissioner, always good to see you.

I want to talk to you about telework policies. You and I have discussed this before, and I understand that you all have a policy now of requiring people to work in-office 50 percent of the time?

Commissioner WERFEL. That is correct.

Senator BLACKBURN. Now how many, what percentage of your employees are teleworking?

Commissioner WERFEL. We are at the governmentwide mandate of 50 percent.

Senator BLACKBURN. So half of your employees are working 50 percent of the time?

Commissioner WERFEL. I think the way to look at it is we have, at any given moment—the way to think about it is, 50 percent of the IRS is working in a remote location, and 50 percent of the IRS is working onsite, if you will randomly pick out a time.

Senator BLACKBURN. Have you all evaluated whether teleworking enables employees to properly work without proper supervision?

Commissioner WERFEL. That is a constant evaluation of ours in terms of, are we hitting our productivity goals? Like are we answering the phones, are we processing, are we getting refunds out, all of the key fundamental mission-critical things we have to do.

Senator BLACKBURN. And you all are about 2 years behind on refunds, right?

Commissioner WERFEL. No.

Senator BLACKBURN. No?

Commissioner WERFEL. We are up to date. We actually had one of the best filing seasons we have ever had.

Senator BLACKBURN. All right. I was asking these questions about telework because of the Tax Court cases regarding IRS Revenue Agent Thomas E. Fields and manager David Combs. They were backdating penalty approval forms during audits of partnerships in 2022.

Mr. Chairman, I have got a *Tax Notes* article to submit for the record.

The CHAIRMAN. Without objection, so ordered.

[The article appears in the appendix beginning on p. 45.]

Senator BLACKBURN. And I think that this type of fraudulent activity taking place within the agency is important to be addressed, and I think it is important that you are doing something to ensure IRS employees are fired and removed when they are found to be in such violation of policy, and that they are properly reprimanded by the respective bar associations.

Commissioner WERFEL. Yes, and look, with respect to the case you raised, we need to do better if we are going to build trust with the American people. We are acknowledging that we should have promptly corrected our representations in court in this case. I have instructed the IRS leadership team to take all the appropriate actions to make sure this never happens again: training, controls, and to the extent appropriate, personnel actions with those involved.

Senator BLACKBURN. Okay. And I think it is important to note this happened during a teleworking time, and without proper supervision.

I want to talk to you—we have discussed before also this issue of total positive income and the $400,000, what is going to happen with those audits.

Now, in the American Families Plan Tax Compliance Agenda—and I have that for the record, Mr. Chairman—Treasury pledged that audits would not increase for taxpayers with incomes below $400,000 in actual income relative to recent levels.

[The agenda appears in the appendix beginning on p. 46.]

Senator BLACKBURN. And one can assume that actual and taxable income would be the same thing, but the IRS has opted to use total positive income. That is the sum, according to what you all have said, of all available income before deductions. Congress has not established a statutory definition for total positive income.

So let's have you clarify, what does TPI account for? Does it allow charitable deductions? If you are gifted money, is it included in that? If you get an insurance settlement or an inheritance, is it included in that TPI? Since there is that definition and then there is actual and taxable, where are we on this?

Commissioner WERFEL. I think as a general rule, you can assume that if it is income, it is included in total positive income. What we are trying to do is give a bright line, an easy way to understand how to distinguish. We believe our commitment of only increasing audit scrutiny on those above $400,000 is a high enough amount, where middle- and low-income people around the country can breathe easier, knowing that they are likely never——

Senator BLACKBURN. Well, my time has run out, but when you say "general rule" and "assume," you know what happens when people end up going to court. So, we are going to have to be more explicit, and I will talk with you about it later.

The CHAIRMAN. Very good.

Next in order of appearance would be Senator Young.

Senator YOUNG. Commissioner, welcome to the committee. Thank you so much for being here today.

When you came before the committee for your nomination hearing, you noted in questions for the record that if confirmed, "it will be a priority of mine to ensure IRS employees are where they need to be to carry out IRS's mission most effectively."

Mr. Commissioner, over a year later, I continue to hear that my constituents are having trouble obtaining assistance from the Internal Revenue Service. My office—like I am assuming all my colleagues' offices—still regularly receives complaints from Hoosiers that the local IRS offices are empty, representatives are not consistently answering the phones, and when someone at the IRS does pick up, there is often no resolution to the issue at hand.

So, Commissioner, I know you are here today touting some customer service improvements, and advocating for additional funds for the IRS. One of the reasons you were put in this position, I think the general perception was, in looking at your background, you are a results-oriented guy.

I know that it is your objective and your team's objective to make sure that you achieve results. I am curious what results you are seeing that indicate success regarding taxpayer services, however. Frankly, the IRS has received billions of dollars in supplemental funding, and yet 2 years later, we are still seeing some poor customer results manifested in the feedback I get from taxpayers.

So, it is my responsibility to press a bit on that issue. I suspect you are going to quote me some data on phone answering rates. Unfortunately, those phone answering rates are not particularly instructive to us because those answered phone calls are not actually leading to resolutions, by my estimation, which is why I continue to hear from my constituents all sorts of lamentations and upset pertaining to the service from the IRS.

So I will just ask you, Mr. Commissioner, and give you an opportunity to respond: why is the IRS just focused on hiring employees to answer the phones instead of focusing on hiring where taxpayer problems remain the most significant, such as the processing of paper returns, responding to correspondence, and resolving taxpayer disputes and issues?

Commissioner WERFEL. So let me start by saying, Senator—I will say up here, we have more work to do. We want every taxpayer in America to feel like, if they need the IRS, we are there for them, that we answer the call, that the person on the other end of the line or the person in the walk-in center or the tool on *irs.gov* meets their needs, and we have not achieved that goal.

So there is no victory lap here. There is a lot more work to do, and as you can imagine, as the IRS Commissioner, 99 out of 100 voices I hear from taxpayers are concerns.

I know that a lot of taxpayers are being served well. I know that things are trending better. I am not going to cite all the statistics.

But I know that we are answering more calls, we are getting more people into those walk-in centers in the Hoosier State. We are serving more people in the Hoosier State than we ever have served before, but that does not mean we are done.

We have more work to do, and we are prioritizing some of the areas that you raised, where we do not answer the calls effectively on some of these topics that we are going to focus on, like victims of identity theft. We need to do more on that, and some of your colleagues on both sides of the aisle have raised really pressing questions, where there are still gaps in the ability of the IRS to serve.

But I want to build on the momentum. Things are getting better. Things are improving in all dimensions of customer service, but the race is not finished.

Senator YOUNG. We are going to stay on top of this issue. As you know, we have a 5-minute question-and-answer format on this committee, and I have roughly 15 seconds left, certainly not enough to continue with this line of questioning. I have put on the record my concerns. I have heard from you that we should remain hopeful but continue to vigorously oversee the IRS, and I will certainly do the latter on behalf of my constituents.

Thank you.

Commissioner WERFEL. Thank you.

The CHAIRMAN. Senator Young, your point about vigorous oversight: that is what our job is all about, and thank you for that.

Senator Cortez Masto is next.

Senator CORTEZ MASTO. Thank you. Commissioner, thank you. It has been a long morning.

I just have two questions for you. One involves the Inflation Reduction Act solar bonus tax credits. I want to thank you for making the Low-Income Communities Bonus Credit program a success in its first year. It is set to deliver nearly 1.8 gigawatts of clean energy in low-income communities across the United States. More residential solar was installed in 2023 than ever before.

Here is my concern though. After reviewing the 2024 program year, the current guidance reduces the amount of capacity for Category 1 residential solar projects. This reduction will negatively impact States like Nevada that have an active residential solar market but no regulatory framework to support community solar, which is where the credit capacity was increased. So residential solar deployed seven times more capacity than community solar last year.

So my question to you is, can you explain that, or can you address the concerns that I have with respect to that?

Commissioner WERFEL. I need to learn more, Senator. Why don't I commit to getting back to your team as early as tomorrow and schedule a follow-up meeting where we can dig into the issue and get the answers to your questions?

Senator CORTEZ MASTO. Thank you. I appreciate that, and I look forward to that dialog.

The only other question I have for you is on the Earned Income Tax Credit. I, like my colleagues, am particularly concerned about one in five taxpayers who are eligible but do not claim the credit. So, what do we need to be doing, and what can the IRS do to reach these families?

Commissioner WERFEL. Yes, it is such an important issue. The last time—for the most recent data we have, there were roughly 7 million Americans who were eligible for EITC that never claimed it. There are a series of steps that we need to take to make sure that people are getting the credits that they are entitled to, in particular vulnerable populations.

These are individuals typically who do not have the means or are intimidated by the IRS in some way, shape, or form. We need to break down those barriers and get these people the credits they are entitled to. We need to do more outreach in communities, working with local community leaders, setting up safe spaces for people to come, learn more about the credit, understand that it is a friendly environment and we are there to help them get the credits they are entitled to.

There is also some work that we can do, for example, potentially to improve the 1040 form, and other things that we can do to make it easier to claim. We are analyzing a variety of different steps, from outreach to the form itself, to anything we can do behind the scenes at the IRS to detect whether someone is eligible and they did not claim, and get out in front of that.

So, we are going to be releasing our updated annual plan in the coming weeks. We have dedicated a new priority section in there to what we are calling "credit uptake." It addresses a lot of these questions, and I look forward to sharing that with you and talking to you more about it.

Senator CORTEZ MASTO. Thank you, Commissioner.

Thank you, Mr. Chair.

The CHAIRMAN. I thank my colleague, and Senator Cardin would be next.

Senator CARDIN. Well, thank you, Mr. Chairman. Mr. Werfel, first of all, I want to thank you. I want to thank you for taking on this challenge. As we have talked about previously, it is an extremely difficult challenge, and we appreciate the commitment that you have made to public service and getting this done.

I want to talk about one area where we have seen a change in the way that athletes are handled among colleges, and whether our tax code is really keeping up with those changes. Senator Thune and I introduced legislation to deal with NIL, and many of the nonprofit organizations associated with colleges are participating.

Our concern is whether that was consistent with their nonprofit tax-exempt status. So you issued a general legal advice memorandum in June 2023. Can you update us as to the enforcement of the tax-exempt status for those organizations that may be going over the line in what they are doing?

Commissioner WERFEL. Yes, we did. We did issue that memorandum. We made it clear in that memorandum that organizations that promote and develop Name, Image, and Likeness opportunities for student athletes are often engaging in what would be a non-exempt purpose. If that is the fundamental thing that you are doing, it is very likely that you are operating for non-exempt purposes.

We have started finding organizations and revoking tax-exempt status or not granting tax-exempt status based on this update. So, this is a new area, right? There is more work to be done. We are

at the early stages of working across stakeholders to make sure they understand what the IRS position is on this.

But I would say that we are at the early stages of implementation, but we have taken some steps with respect to certain organizations and enforced the general legal advice memorandum that we issued in May 2023.

Senator CARDIN. Senator Thune operated with me on this because we saw some real abuses of this by certain organizations that were not rewarding athletes, but trying to enhance the ability to recruit, rather than giving benefit to a person because of their name or likeness.

Commissioner WERFEL. Yes. I should be clear that we do not have any opinion, good or bad, on NIL as an area of the economy.

Senator CARDIN. Nor do we.

Commissioner WERFEL. It is, just do it, but play by the rules.

Senator CARDIN. That is our exact point. We want people to be rewarded for their—we do not want to see it abused.

Commissioner WERFEL. Yes.

Senator CARDIN. So, I would appreciate it if you would keep us informed as to how your enforcements are going in that area, and if you need additional help from us.

Commissioner WERFEL. Absolutely.

Senator CARDIN. I want to follow up on Senator Cortez Masto's points in regards to low-income families. The VITA program is one program that has been helping low-income taxpayers get the help that they need. Your Direct File—I know it is a pilot program. We expect that will help. You mentioned trying to simplify the forms.

Can you just tell me your strategies to try to help lower-income taxpayers who struggle when trying to comply and get the benefits of our tax code?

Commissioner WERFEL. Well, it is multifaceted. I was actually recently, Senator Cardin, at a VITA clinic in Baltimore. I have seen the good works that are going on there to provide free tax services to distressed communities or vulnerable populations. It is inspiring work, and we need to do more of it.

We should be investing in growing these volunteer programs, working in local communities, working with local universities to provide these free services. These are the environments where we can really connect people to their Earned Income Tax Credit who might otherwise not be.

So, it is about awareness campaigns, it is about working with local partners, it is about setting up environments like a VITA clinic, where people feel that they can come in and they understand the benefits that are provided.

There are also things that we can do behind the scenes at the IRS. I mentioned to Senator Cortez Masto we are looking at updates to the 1040 potentially, and other changes to the forms. What can we do to make it absolutely clear and easy for taxpayers to apply for the Earned Income Tax Credit, because if 7 million Americans are eligible and are not applying, something is not connecting correctly, and we want to fix it.

Senator CARDIN. And it is also protecting them against paid preparers that are abusing lower-income families.

Commissioner WERFEL. Exactly. Protecting them from scams, exactly.

Senator CARDIN. And you need that authority. Thank you.

Commissioner WERFEL. Thank you.

The CHAIRMAN. I thank my colleague.

The Senator from Wyoming.

Senator BARRASSO. Thanks so much, Mr. Chairman. Commissioner, thanks for being here today.

Commissioner WERFEL. Thank you.

Senator BARRASSO. I want to talk with you about this Direct File pilot program.

Commissioner WERFEL. Please.

Senator BARRASSO. I know you have talked to some others about it today. A couple of things——

Commissioner WERFEL. Yes.

Senator BARRASSO [continuing]. Because you know, there has been a lot of controversy surrounding the IRS's starting up this direct filing portal that could replace successful private-sector options that are currently available to taxpayers around the country.

You know, unlike the current Free File process, which you know partners with the private sector, this would be solely handled by the Internal Revenue Service, make the IRS both the tax collector as well as the tax preparer.

The so-called Inflation Reduction Act did provide $15 million for the IRS to study the feasibility of a government-run Direct File system, but it did not provide statutory authority to create and operate a new multimillion-dollar Direct File program.

So to me, in a classic big file fashion, the IRS spent $130 million on a Direct File program, and only 55,000 people, as of at least a couple of weeks ago, used the program. So the IRS spent over $2,000 per taxpayer, and when you compare that to the private-sector Free File options serving roughly 30 million taxpayers, they cost the taxpayers and the government nothing.

So, 18 State Treasurers, including my Wyoming State Treasurer, Curt Meier, sent a letter asking you to terminate the program. They called this a solution in search of a problem. The Treasury Inspector General for Tax Administration has also raised some concerns.

Last week, the Government Accountability Office released a report listing out problems with this new IRS program. So, do you think the IRS can do a better job than the private sector at helping taxpayers?

Commissioner WERFEL. I think what we are trying to do, Senator, is provide an option for taxpayers that is not supposed to be better or worse. It is supposed to give taxpayers options. I also would offer that the pilot is not done. There have been no cost estimates.

You referenced a cost estimate in your question that I am unfamiliar with. I do not think it is going to end up being an accurate cost estimate. There are way more taxpayers who have filed with Direct File in the past few days, so the numbers are very different than you have in front of you.

But I will say this, that we have not made a decision on the future of the program, that after the pilot is done—and we still have

Massachusetts filing through April 17th, and they are one of our pilot States—we will report publicly on the results.

I will be able to provide a final cost number, a final number of taxpayers, and we will give opportunities for your State Treasurer to react to the data and provide us feedback, and we look forward to that feedback.

Senator BARRASSO. Yes, and I will see the State Treasurer this weekend at home in Wyoming. Again, he is a big private-sector guy, as am I. And the question is, does the private sector have the same, what I consider maybe a conflict of interest that the IRS has, if the IRS is the tax collector or the tax auditor or the tax enforcer and now the tax preparer—judge, jury, and lord high executioner.

Commissioner WERFEL. My answer to that is twofold. One, I do not consider us the preparer. We provide the platform. The taxpayer inputs the information and makes the final sign-off.

Second, it is an option. If the taxpayer feels like this is too much IRS for them, they can use any other option that is available to them, including using the free solutions that are offered by the software companies. I encourage them to. They are very good products.

Senator BARRASSO. Can I ask you what safeguards you have put in place at the IRS to protect taxpayers from either conflict of interest as well as any additional information the IRS will now have relating to taxpayers?

Commissioner WERFEL. It is the same as I just mentioned. First of all, it is your option. We try to be as transparent as we can about what the parameters of Direct File are and what they are not, and we make it very clear that there are other ways to file your taxes. You do not have to file with Direct File.

We have allowed taxpayers to make the final call. They hit submit. They review the form. They make the final decisions on what they submit, and once they submit it, their data goes into the same pool of data as any other tax filing coming in.

So it has equal protection in terms of data security. There is no real change in your status as a taxpayer once you hit submit on Direct File versus hitting submit on any other solution.

Senator BARRASSO. So, when you were here last year, I voiced my concerns about funding priorities. The so-called Inflation Reduction Act allowed roughly $80 billion to the Internal Revenue Service. Forty-five billion dollars went for enforcement, compared to only $3 billion in taxpayer services. We talked about that in my office; we talked about it in the hearing. In the recent budget request, the IRS asked for another $104 billion in mandatory spending. Of that, $50 billion is for enforcement.

This will be on top of almost $5.5 billion provided for enforcement annually through regular appropriations. Are small business owners and hardworking taxpayers really going to be protected from some of the burdensome onslaught of audits if you spend more than $100 billion on auditors and enforcement agents in the next 10 years?

Commissioner WERFEL. Those are my marching orders, and as long as I am Commissioner——

Senator BARRASSO. Not from anybody on my side of the aisle.

Thank you, Mr. Chairman. My time has expired.

The CHAIRMAN. The time of the gentleman has expired.

Senator Casey?

Senator CASEY. Thanks, Mr. Chairman. Commissioner, great to be with you, and congratulations on a successful filing season, and thanks for being here today.

I am pleased that the IRS continues to use the money appropriated in the Inflation Reduction Act to improve taxpayer services, with call wait times down to 3 minutes after being up to 28 minutes just 2 years ago, and more filing options available than ever before.

I am also pleased you announced an increase in audits of large complex partnerships with more than $10 billion in assets, and you will pursue the 25,000 millionaires who neglected to file their taxes since 2017—a much bigger number when you lower that below a million dollars.

So here is my first question. Can you explain what the IRS is doing with this new funding to ensure that billion-dollar companies, millionaires, or higher, pay what they owe, just like middle-class Americans have to?

Commissioner WERFEL. I appreciate the question, especially because I just want to close out my response from Senator Barrasso. My marching orders are to make sure that Inflation Reduction Act funds are exclusively used on enforcement of high-wealth complex organizations, large partnerships, large corporations, and that is where our focus is.

If you are a mom and pop, middle or low income, there is no new wave of audits coming under the Inflation Reduction Act. The audit rate you had the day before the Inflation Reduction Act, which was historically low, is the same audit rate you had the day after, and the same audit rate you will have today, and the same audit rate into the future. So again, no new wave of audits.

We have a lot of work to do to deal with the complexity that exists in the U.S. economy today, and how large corporations, complex partnerships, and very wealthy individuals are shielding income. Many are not. Many are playing by the rules, and I would like to say that our focus on high-wealth and large businesses benefits high-wealth and large businesses, because if you are the CFO of a major corporation and you are playing by the rules, you want the other company that you might be competing against to also play by the rules.

You want the IRS to be able to know which case to select for audit. By having the right funding, we can be more precise. Those who are playing by the rules will never have to hear from us if we are smarter, more technical, and more competent in this complexity.

And that CFO who is playing by the rules will also have the comfort of knowing we are not selecting them for audit, but we are selecting those in their industry that may not be playing by the rules. That is going to create fair competition.

So this is really about an IRS that can do its job and enforce the code fairly and equitably. If we do not have the resources to be able to spot and deal with the complexity we are seeing, then the system starts to degrade.

Senator CASEY. Thanks very much.

Commissioner, you might be aware that in February 2023, a Norfolk Southern train carrying hazardous materials derailed in East Palestine, OH, very close to the Pennsylvania border, just feet away from Pennsylvania. The township is Darlington, the township in Pennsylvania.

To avoid toxic exposure from the crash and the burning of the leaked toxic materials, thousands of people in Ohio and hundreds in Pennsylvania had to flee their homes. Norfolk Southern later provided some reimbursements for the families' hardship.

Senator Brown and I have been working to make sure the victims of this disaster are not taxed on these reimbursements that they received from Norfolk Southern. I hope we can deliver on this tax assistance to the victims by passing the Wyden-Smith bipartisan tax bill.

But if not, if that does not happen, I hope that you and Secretary Yellen will use your authority to declare that this was a catastrophic disaster, and that related payments are exempt from tax. Can you assure us that you will do everything in your power to deliver tax relief to Norfolk Southern derailment victims?

Commissioner WERFEL. Yes, absolutely. I mean, this is one of those spots—and we have talked a lot today about IRS authorities. I mentioned on many occasions that I think one of my fundamental responsibilities as Commissioner is to implement the tax code in a way that protects the Taxpayer Bill of Rights. I was just reviewing its—it is actually section 7803(a)(3), which requires me to implement the tax laws consistent with a delineated set of Taxpayer Bill of Rights.

I think that is one of the most important provisions that I have as Commissioner, and this is a moment where you basically look for opportunities to protect taxpayers, because you have this Taxpayer Bill of Rights that is balancing against what might be a part of the tax code that has this unintended consequence of placing undue burden, or not really understanding the situation.

I think the Wyden-Smith bill on disasters is going to be enormously helpful, but in the meantime, we are rolling up our sleeves to find a solution for the residents of East Palestine.

Senator CASEY. Thanks very much.

The CHAIRMAN. The time of the gentleman has expired.

Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman. Commissioner, good to see you.

Contrary to the standard in most professions, paid preparers are not obligated to hold a license. While many tax return preparers offer exceptional and professional services, yet regrettably there are some who take advantage of the lack of oversight of the market to take advantage of hardworking taxpayers.

These "ghost preparers," as some call them, or other unscrupulous preparers often promise hefty returns, claim credits for taxpayers that they are ineligible for, and charge fees based on the inflated refund amounts. Then the preparer will balk at signing or providing their IRS preparer tax ID number, as mandated by law, leaving the taxpayer exposed and potentially liable for any inaccuracies on their returns.

Commissioner, what have you done or what can you do to crack down on fraudulent tax preparers, and what additional resources and authority, if any, does the IRS need to eliminate this practice?

Commissioner WERFEL. What we have tried to do, Senator, within our legal authorities that we have, is lean in, do more awareness campaigns, work with taxpayers on the risks of ghost preparers. That only gets you so far, but it does not mean we should not be leaning in to do more of these awareness campaigns.

We have put in the President's budget a variety of different provisions that would help us with cracking down on ghost preparers and other unscrupulous preparers, new tax penalties that would be created, allowing us to determine more comprehensively whether a tax preparer is suitable or not. There are certain restrictions that we have at the IRS in terms of being able to essentially regulate this space, and this is a spot where I think regulations would be helpful, because in particular, vulnerable populations in distressed communities need help if they do not have the means to hire an accountant or a lawyer, and we should be helping them.

Senator MENENDEZ. I would very much like to hear from you—not right now—and your staff about what type of authorities or regulations you would like to see to be able to be more successful in this regard.

Commissioner WERFEL. Yes.

Senator MENENDEZ. You know, I would imagine that if a law says that if you are a tax preparer and you fail to put your tax ID purposely, that making that some type of a crime is a real incentive not to do that. So anyhow, I would like to hear from you on it.

Commissioner WERFEL. I appreciate the question.

Senator MENENDEZ. Last year, a collaborative study by Stanford University and the Department of the Treasury uncovered that Black taxpayers face over three times the likelihood of being audited by the IRS. The absence of race or ethnicity data collected by the IRS obscures the roots of this inequality.

But the report points to potential discrimination embedded with the audit selection algorithms. At your confirmation hearing, you and I had a little bit of a discussion about this. Additionally, the research highlights the disproportionate audit rates targeting individuals claiming the EITC.

Commissioner Werfel, in a letter to you from Chairman Wyden, you committed to identify and implement changes prior to the next tax filing season. Within the framework of the Inflation Reduction Act strategic operating plan, the IRS has pledged to engage in research aimed at comprehending any systemic bias.

A primary focus with this initiative is the continual assessment of algorithms for selecting audits related to the EITC, for example. So my question is, what are the findings of your research thus far? The Stanford report did not conduct research into potential audit biases for Latino taxpayers, but as you work on this issue, will you commit to evaluating Latino taxpayers as well?

Commissioner WERFEL. Yes. Let me start by saying as I sat here on February 15, 2023 at my confirmation hearing when this report had just come out, it was alarming and concerning, and I wanted to get to the IRS and roll up my sleeves and address it.

First thing I did when I got to the IRS was respond to Mr. Chairman's request for an update. I provided an update. I told him—and I acknowledged the validity of the findings, acknowledged that there were racial disparities in how we selected audits for certain refundable credits including EITC, and committed to doing something about it.

We have dramatically reduced the number of EITC audits. We made changes to our selection algorithm. We have done more outreach to impacted stakeholders. We are working with the Census Bureau and others to make sure we are setting up the right data infrastructure in order to better evaluate the racial disparity, potential racial disparity of any tax administration, so that this does not happen again.

The results are that I committed to the chairman that I would be prepared by the fall of 2024 to start unpacking some of the results of what these steps are, and I still think we will make that deadline.

Senator MENENDEZ. Well, I look forward to hopefully you sharing that with us, and I hope you will look at Latinos as part of the overall effort.

Commissioner WERFEL. Absolutely.

Senator MENENDEZ. Fairness is an essential part of your mission, so thank you.

The CHAIRMAN. Very important.

Mr. Commissioner, you have been in that seat for almost 2½ hours, and I am going to liberate you here very briefly, in just a couple of minutes. In particular, we have dealt with an array of very substantive and important issues. I think, for example, we could have a debate further about Direct File.

I mean, there has been back and forth; it has been a partisan exercise. I have to just say for history, that is just not accurate. In that seat over there sat, at one time, Dan Coats of Indiana, and he joined me in a bipartisan tax reform bill that included a version of Direct File.

Now that was history, and I know sometimes history feels like the last minute, but there really are bipartisan roots in this Direct File effort, and I am appreciating the way you described this as similar to building a startup, because I think that is very appropriate.

And also, I want you to know, we are going to pull out all the stops to pass this tax bill—bipartisan, 357 votes in the House of Representatives. You cannot get 357 votes to order a piece of apple pie, and this is just an extraordinary accomplishment.

Chairman Smith deserves an enormous amount of credit. The bipartisan work went on for months and months. And the provision we talked about today, dealing with the fraudsters—I mean, this is now a bill that is on offer, to give you the tools to go after these fraudsters. And you have made it clear that you are not going to be able to do the job that you want to do without the enforcement capability, so I appreciate that.

But I am going to close with this. I have had at home about 1,060 town hall meetings, and the way you come to the Finance Committee seems to me to be almost a town hall meeting. You know, you get a lot of questions from Senators. That is what we

get an election certificate for, and you either answer them or you say, "I have to get back to you because we do not know X, Y, and Z."

This is not just an isolated event. You have been available for roundtables. Senators have asked you to come to meetings privately, sessions just in the office, in my Senate office, to come and talk for 40 minutes or something like that.

So, you have been open and accountable. That is what public service is supposed to be all about. I want you to know I appreciate it.

I want colleagues to know that questions for the record are due by 5 p.m. next Tuesday. With that, Mr. Commissioner, we will excuse you.

[Whereupon, at 12:54 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

SUBMITTED BY HON. MARSHA BLACKBURN,
A U.S. SENATOR FROM TENNESSEE

Easement Litigants Allege Penalty Backdating in Three More Cases

by Kristen A. Parillo

[*TAX NOTES FEDERAL,* VOLUME 180, AUGUST 28, 2023]

Emails between an IRS examiner and his manager show that they backdated penalty approval forms during audits of three syndicated easement partnerships, according to Tax Court documents filed by the partnerships.

The backdating allegations and email exchanges are included in a first request for admissions filed with the Tax Court on August 16th by each of the petitioners in *Arden Row Assets LLC v. Commissioner, Basswood Aggregates LLC v. Commissioner,* and *Delwood Resources LLC v. Commissioner*.

The petitioners are represented by Todd Welty of Todd Welty PC, who is handling another Tax Court syndicated easement case, *LakePoint Land II LLC v. Commissioner* (Dkt. No. 13925–17), involving allegations that an IRS supervisor backdated her signature on a penalty approval form.

The IRS's compliance with section 6751(b) has been a contentious issue in Tax Court litigation for the last several years, particularly in syndicated conservation easement cases. The provision states that the IRS may not assess a penalty unless the initial determination is approved in writing by the immediate supervisor of the employee who made it.

Arden Row Assets LLC, Basswood Aggregates LLC, and Delwood Resources LLC each filed a Tax Court petition March 21st to challenge the IRS's disallowance of a conservation easement deduction they claimed on their 2018 partnership tax return.

Each easement was donated over land "with significant limestone reserves" in Jackson County, Alabama, according to the petitions. Arden Row, Basswood, and Delwood each claimed charitable contribution deductions of $57 million. For each partnership, the IRS asserted penalties under sections 6662A, 6662(c), 6662(d), 6662(e), and 6662(h).

The audits were conducted under the centralized partnership audit regime enacted by the Bipartisan Budget Act of 2015. In notices of final partnership adjustment issued to each partnership, the IRS determined an imputed underpayment of around $21 million in income tax and $8.4 million in penalties.

Audits of all three partnerships were handled by revenue agent Thomas E. Fields and team manager David M. Combs. *LakePoint* involved a different set of IRS employees: revenue agent Pamela Stafford and her immediate supervisor, revenue agent Catherine Brooks. The IRS has acknowledged in *LakePoint* that Brooks "misdated" the penalty approval form but argues there was no bad faith or fraud.

Emails Raise Questions

The request for admissions filed by each petitioner—worded nearly identically—asks the IRS to confirm that it is contending that the revenue agent made the "ini-

tial determination" to assert penalties on July 12, 2021, and that the team manager approved that determination 2 days later.

The request notes that, according to email exchanges attached as exhibits, the agent merely told his manager on July 12th that there would likely be penalties asserted against each partnership. The agent didn't specify the applicable penalties or basis for asserting them, the request says. It further notes that in his July 14th response to the agent, the manager simply wrote in the subject line that he approved the penalties—again, without specifying the penalties he was approving or the basis for asserting them.

In a March 11, 2022, email in which the agent asked the manager to sign penalty approval lead sheets for the three partnerships, the agent wrote: "Ideally (?) the date you use to sign should be either the date you 'approved' penalties against Taxpayer (7/14/21) . . . or a little thereafter?"

The request for admissions asks the IRS to admit that at the time the March 11, 2022, email was sent, no penalty approval lead sheet or similar form had been signed by the team manager and that the agent was asking the manager to backdate his signature on the lead sheet to July 14, 2021, or shortly after that date.

The request further asks the IRS to admit that in his March 11, 2022, email, the agent attached workpapers and a signed penalty lead sheet from a different (unrelated) audit so that the manager had "backup" examples. The request notes that in his March 14, 2022, response to the agent, the team manager wrote: "All 3 are signed with the date of July 14, 2021. Thanks for giving me all the 'backup' too!"

That email shows that the manager was admitting to backdating penalty consideration lead sheets for three separate audits, the request says, adding that the manager "knew when he signed those three penalty consideration lead sheets that it was March 2022, not July 2021."

The request also asks the IRS to admit that the manager's signature on the lead sheet "was copied and pasted from another document," and that the agent "comingled information, documents, and workpapers from three separate taxpayers in his work on the Audit."

The cases are *Arden Row Assets LLC v. Commissioner* (Dkt. No. 3817–23); *Basswood Aggregates LLC v. Commissioner* (Dkt. No. 3820–23); and *Delwood Resources LLC v. Commissioner* (Dkt. No. 3821–23).

U.S. DEPARTMENT OF THE TREASURY

THE AMERICAN FAMILIES PLAN TAX COMPLIANCE AGENDA

MAY 2021

I. Executive Summary and Introduction

President Biden recently proposed the American Families Plan, advancing comprehensive and necessary investments in American children and families. To help support this important agenda and increase fairness in the tax system, the President also proposed a set of tax compliance measures to foster a tax system where Americans pay the taxes they owe.

This report describes the President's tax compliance initiatives that seek to close the "tax gap"—the difference between taxes owed to the government and actually paid. According to Treasury analysis, the tax gap totaled nearly $600 billion in 2019 and will rise to about $7 trillion over the course of the next decade if left unaddressed—roughly equal to 15 percent of taxes owed. These unpaid taxes come at a cost to American households and compliant taxpayers as policymakers choose rising deficits, lower spending on necessary priorities, or further tax increases to compensate for the lost revenue.

The magnitude of the tax gap means that compliance initiatives have the potential to raise substantial revenue, but these reforms also improve tax progressivity and economic efficiency. While roughly 99 percent of taxes due on wages are paid to the Internal Revenue Service (IRS), compliance on less visible sources of income is esti-

mated to be just 45 percent.[1] The tax gap disproportionately benefits high earners who accrue more of their income from non-labor sources where misreporting is common. Further, the tax gap imposes distortions because of the resources some expend to avoid paying taxes and the incentives created to shift economic activity into certain areas where tax liabilities can be illegally evaded.

To raise revenue, improve efficiency, and build a more equitable tax system, investments in tax compliance are of first order importance. The compliance proposals in the American Families Plan provide the IRS with the resources and information it needs to overhaul and enhance tax administration. These policy changes are integral to addressing evasion, but they also prioritize improving taxpayer service and the experience of Americans as they navigate the tax system. Taxpayers would benefit from effective communication with the IRS, access to the tax credits to which they are entitled, and competent assistance as they file their taxes.

The President's compliance agenda has several transformational elements:

1. **Provide the IRS the resources it needs to address sophisticated tax evasion.** The first step in the President's tax administration efforts is a sustained, multi-year commitment to rebuilding the IRS, including nearly $80 billion in additional resources over the next decade. The IRS would grow manageably (no more than around 10 percent annually) but also have certain funding in place to make investments with large fixed costs—like modernizing information technology, improving data analytic approaches, and hiring and training agents dedicated to complex enforcement activities. This would make up the ground that the IRS has lost over the last decade. During this time, the IRS budget fell by about 20 percent, leading to a sustained decline in its workforce particularly among specialized auditors who conduct examinations of high-income and global high net worth individuals and complex structures, like partnerships, multi-tier pass-through entities, and multinational corporations.
2. **Provide the IRS with more complete information.** When the IRS can verify taxpayer filings with third-party information reports, such as the W–2 forms submitted by employers to report wages, compliance rates exceed 95 percent. Without third-party reporting, compliance rates fall below 50 percent and thus lead to an inequitable asymmetry in tax collections depending on the form in which income is accrued. The Government Accountability Office (GAO) and IRS agree that strengthening third-party reporting is one of the most effective ways to improve tax compliance. The President's proposal leverages the information that financial institutions already know about the accounts that they house. Financial institutions would add information about total account outflows and inflows to existing reporting on bank accounts. Importantly, there are no added requirements for taxpayers. The IRS will be able to deploy this new information to better target enforcement activities, increasing scrutiny of wealthy evaders and decreasing the likelihood that fully compliant taxpayers will be subject to costly audits. As a result, voluntary compliance will rise through deterrence as would-be tax evaders realize that the IRS has an additional lens into previously unreported income streams.
3. **Overhaul outdated technology to help the IRS identify tax evasion and serve customers.** The IRS still relies on Individual and Business File Systems that date back to the 1960s—the oldest in the Federal Government. The result is decades upon decades of tax administration built upon a system that is written in a programming language that is no longer taught, and where new functions are added in a patchwork rather than integrated manner. Modernization funding would allow the IRS to address technology challenges and develop innovative machine learning that can be deployed to better identify suspect tax filings, for example, by comparing returns to similarly situated taxpayers and historical filings in a way that the current IRS ecosystem does not allow. These resources would also support efforts to meet threats to the security of the tax system, like the 1.4 billion cyberattacks the IRS experiences annually. With a revitalized IRS, taxpayers would also be able to communicate with and receive guidance from the IRS in a clear, timely manner when questions arise. Further, modernized IT would help improve taxpayer service and ensure that the IRS is able to effectively and efficiently deliver tax credits to eligible families and workers, including recent expansions to the Child Tax Credit, the Earned

[1] IRS, 2019. "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013." Publication 1415 (Rev. 9–2019).

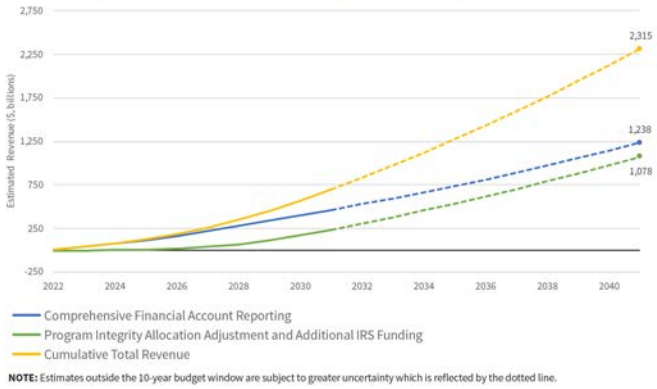
Income Tax Credit, and the Child and Dependent Care Tax Credit proposed in the American Families Plan.

4. **Regulating paid tax preparers and increasing penalties for those who commit or abet evasion.** Taxpayers often make use of unregulated preparers who lack the training to provide accurate tax assistance. These preparers submit more returns than all other preparers combined, and taxpayers rely on their guidance, in part because of challenges in reaching the IRS in a timely manner when questions arise. In addition to the regulation of paid preparers and service improvements that would simplify tax filing, the President's proposal includes additional sanctions for so-called "ghost preparers" who fail to identify themselves on the tax returns which they prepare.

Experts at the Treasury Office of Tax Analysis estimate that these initiatives would raise $700 billion in additional tax revenue over the next decade. This revenue is backloaded in the 10-year budget window as several of these new investments—such as hiring revenue agents capable of complex global high net-worth examinations and building the technological infrastructure to support a new information reporting regime—take years to reach their full potential. As Figure 1 shows, the revenue raised in the second decade amounts to $1.6 trillion.

These estimates are conservative because the revenue potential of additional resources for tax administration is based on return on investment (ROI) estimates from the IRS that only exist for adjustments detected through current enforcement-related activities. Benefits of other foundational shifts in tax administration that would result from this proposal—for example, overhauling and integrating IT systems and restoring trust in the IRS through timely support for taxpayers—are also unaccounted for. Moreover, although revenue estimates for increased information reporting include the effects of this regime on voluntary compliance, estimates for increased enforcement actions do not account for deterrent effects, which are generally considered qualitatively significant.

Figure 1: Revenue Raised from Compliance Initiatives, 2022–2040



NOTE: Estimates outside the 10-year budget window are subject to greater uncertainty which is reflected by the dotted line.

II. Defining and Measuring the Tax Gap

A well-functioning tax system requires that taxpayers make good on their tax obligations. An important measure of our tax system's administrative effectiveness is the "tax gap"—the aggregate difference between Federal taxes owed and taxes paid voluntarily and on-time. The size of the tax gap has meaningful implications for fiscal policy, while the distribution of the tax gap across income levels has important consequences for tax progressivity.

The IRS periodically releases estimates of the Federal tax gap. The most recent estimates, covering years 2011–2013, showed an average gross tax gap of $441 billion annually. After late payments and enforcement efforts are factored in, the net tax gap over this period is estimated at $381 billion. Extrapolating for growth in the intervening years, for tax year 2019, the gross tax gap was estimated at $584 bil-

lion, and is on pace to total $7 trillion over the course of the next decade. This is almost 3 percent of GDP on an annualized basis. These estimates imply a voluntary compliance rate of around 84 percent, and a net compliance rate of around 86 percent.[2,3]

The tax gap has three distinct elements: taxpayers who fail to file returns in a timely manner (the "nonfiling" tax gap, around 9 percent of the gross tax gap); those who underreport income or overclaim deductions and credits on tax returns (the "underreporting" tax gap); and those who underpay taxes despite reporting obligations in a timely manner (the "underpayment" tax gap, around 11 percent). By far the largest contributor to the tax gap is the underreporting gap—around 80 percent.[4]

Table 1: Tax Gap Estimates Over Time

Tax Gap Estimates and Projection

Tax Gap Component	TY 2011–2013 Published	TY 2019 Projection [1]	TY 2019 Projection, Adjusted [2]
Estimated Total True Tax	**$2,683**	**$3,589**	**$3,635**
Gross Tax Gap	**$441**	**$584**	**$630**
Nonfiling Tax Gap	$39	$52	$52
Underreporting Tax Gap	$352	$466	$512
Underpayment Tax Gap	$50	$66	$66
Voluntary Compliance Rate	**83.6%**	**83.7%**	**82.7%**
Enforced and Other Late Payments	**$60**	**$76**	**$76**
Net Tax Gap	**$381**	**$508**	**$554**
Net Compliance Rate	**85.8%**	**85.8%**	**84.8%**

[1] Estimates based on applying the tax gap projection technique (which assumes constant compliance rates by major component of income) to the TY 2011–2019 IRTF and BRTF data.

[2] Estimates based on adjusting compliance rates for Guyton et al. (2021) estimate that the published tax gap was understated by an annual average of $33 billion (in 2012 dollars) in underreported income from offshore wealth and pass-through entities in TY 2006–2013, then applying constant compliance rates by major component of income.

Many attempts to assess the tax gap rely on a sample of random audits that the IRS undertakes to estimate the share of unpaid taxes. The most prominent of these studies examines individual income tax returns. Such random studies are generally thought of as the "gold standard" for understanding tax evasion. However, these audits can struggle to capture the full extent of tax evasion for high-income taxpayers because sophisticated taxpayers and those who advise them are well-positioned to shield unpaid taxes from audit detection.[5] This has led some scholars to suggest that the results from studies based on IRS "National Research Program" (NRP) random audit data may not satisfactorily capture tax evasion by the very wealthy tax-

[2] The voluntary compliance rate is defined as the amount of taxes paid "voluntarily and timely" divided by "total true tax," and corresponds to the gross tax gap. The net compliance rate is higher because it is the ratio corresponding to the net tax gap, after "enforced and other late payments" are added to the numerator of this ratio. Greater enforcement efforts increase both the voluntary compliance rate and taxes collected through enforced and other late payments. Ibid.

[3] The IRS tax gap report shows that average annual Federal taxes owed and voluntarily paid on time for 2011–2013 were about $2,242 billion and total estimated annual tax liability was about $2,683 billion, for a voluntary compliance rate of about 84 percent. This rate has been relatively constant since the 1970s. Ibid.

[4] *Ibid.*

[5] For example, capital income accruing to offshore accounts have until recently not been subject to reporting requirements that make them easily traceable in audits. In addition, pass-through income accrues disproportionately to high earners and can be challenging to attribute to its ultimate owner.

payers, and that tax gap estimates are significantly understated because they do not fully reflect this sophisticated evasion.[6]

The IRS attempts to mitigate this by adjusting for income undetected by audits through "Detection Controlled Estimation" (DCE), a methodology under which detected evasion is used to estimate the magnitude of undetected evasion. DCE adjustments are intended to bring the amounts of estimated non-compliance in line with the amounts detected by the most specialized auditors. In the aggregate, these adjustments roughly triple the estimated amount of unreported income. But even DCE estimates may not fully account for the most sophisticated evasion techniques, undetected income, and unidentified emerging issues. One estimate of the magnitude of this issue is shown in Table 1, which illustrates that adjusting the tax gap for pass-through and offshore evasion increase the tax gap significantly.

Research also finds that underreporting tends to rise with income when taxpayers are ranked by their total income, including the unreported amount.[7] In part, tax evasion rises with higher incomes because higher-income taxpayers have sophisticated accountants and tax preparers who can stake out aggressive tax positions that can help shield true tax liability. And because the IRS lacks the number of specialized auditors needed to adequately detect and pursue these instances of noncompliance, the consequences of tax underpayment are perceived to be minor, and voluntary compliance rates are lower.

But the distribution of the underreporting tax gap is also a byproduct of the current information reporting regime. For some, but not all, categories of income, the IRS can crosscheck taxpayer filings because it receives information reports from third parties, like employers, and this information can be used to verify that taxpayers are accurately reporting income and deductions. When taxpayers know that their tax information is being reported to authorities, their voluntary compliance rate increases.

For ordinary wage and salary income, where employers share a Form W–2 with both employees and the IRS (as well as automatically withhold income taxes), compliance is very high, with only an estimated 1 percent misreporting rate.[8] As Figure 2 shows, compliance drops off with a decline in third party information reporting. For income subject to substantial information reporting, but not withholding, estimated misreporting rates are 5 percent. For income subject to some limited information reporting, misreporting rises to 17 percent. In stark contrast, for opaque income sources that accrue disproportionately to higher earners—like proprietorship income and rental income—misreporting is estimated to be 55 percent. The IRS and GAO have identified increased information reporting as one of the best ways to improve taxpayer compliance because providing the IRS with a lens into opaque income sources both improves enforcement activities and encourages voluntary compliance by taxpayers who perceive that the IRS has information necessary to pursue them should they not meet their tax obligations.[9]

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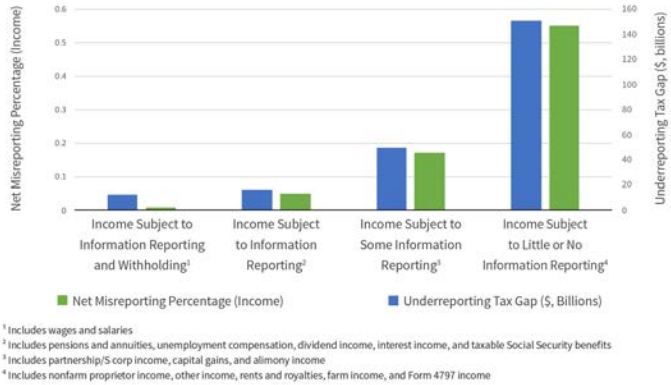
[6] *See, e.g.,* Alstadæter, Annette, Niels Johannesen, and Gabriel Zucman, 2019. "Tax Evasion and Inequality." *American Economic Review,* 109(6): 2073–2103.

[7] *See, e.g.,* Guyton, John, Patrick Langetieg, Daniel Reck, Max Risch, and Gabriel Zucman, 2021. "Tax Evasion at the Top of the Income Distribution: Theory and Evidence," NBER Working Paper No. 28542. The estimates in Guyton et al. (2021) are based on imputations of undetected evasion using multipliers developed from earlier audit data. The advisability of so-called "detection-controlled estimation" (DCE) adjustments are debated in the literature, especially with respect to understanding the distribution of noncompliance (*see also* DeBacker, Jason et al., 2020. "Tax Noncompliance and Measures of Income Inequality," *Tax Notes Federal,* 17 February; and Johns, Andrew and Joel Slemrod, 2010. "The Distribution of Income Tax Noncompliance," *National Tax Journal,* 63(3)).

[8] IRS, 2019. "Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013."

[9] GAO, 2019. "Multiple Strategies are Needed to Reduce Noncompliance: Statement of James R. McTigue, Jr., Director, Strategic Issues," GAO–19–558T.

Figure 2: Misreporting by Income Category



[1] Includes wages and salaries
[2] Includes pensions and annuities, unemployment compensation, dividend income, interest income, and taxable Social Security benefits
[3] Includes partnership/S corp income, capital gains, and alimony income
[4] Includes nonfarm proprietor income, other income, rents and royalties, farm income, and Form 4797 income

Although less is known about the distribution of the nonfiling and underpayment tax gaps, a recent Treasury Inspector General report highlights the importance of high-income nonfilers [10] as contributors to the tax gap. The report notes that since 2010, the estimated number of high-income non-filers has risen by nearly 50 percent as a resource-constrained IRS lacked the ability to pursue all of these cases. Between 2014–2016, the Inspector General's report identified nearly 900,000 high-income nonfilers, of which 400,000 cases (44 percent of cases) were never investigated due to resource constraints. Of these 400,000 cases, 300 of the most egregious evaders cost the Federal Government $10 billion in unpaid tax liabilities over this period.[11] The IRS is already working to address this issue: In 2018, it established a program to pursue all high-income nonfilers for tax years from 2016 through 2019, and it intends to select all high-income nonfiling cases for enforcement action for tax years 2020 and beyond.

III. IRS Challenges With Compliance

Given the current magnitude of the tax gap in the United States, large compliance initiatives will have benefits that far exceed costs. One illustration of the large potential return on these resource investments is provided by the IRS, which estimates that $1 spent on tax enforcement typically yields at least $4 in direct revenue (for example, increased tax payments collected from high-income nonfiler audits).[12] This direct increase in additional tax revenue that the IRS is able to collect from compliance efforts does not include the indirect effects of greater enforcement activities, as evidence suggests that taxpayers are more likely to be compliant in the presence of visible, robust enforcement efforts.

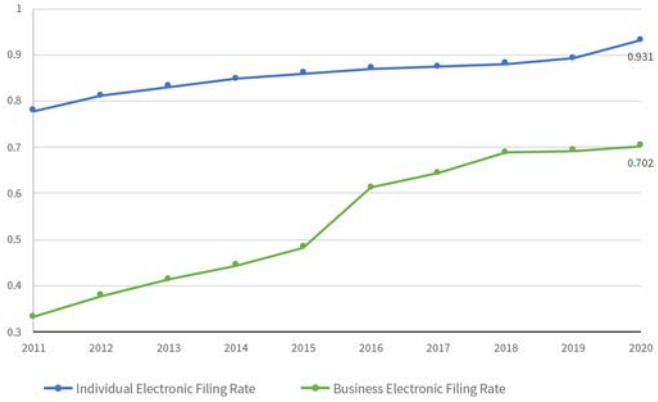
Technology (and, in theory, the ability to detect tax evasion) has developed significantly in recent years. In the late 1990s, only about 10 percent of individual income tax returns were filed electronically and the vast majority of the IRS's enforcement activities focused on returns filed on paper. The Internal Revenue Service Restructuring and Reform Act of 1998 helped change this by setting an ambitious goal of reaching an 80 percent electronic filing rate over the course of the decade following 1998. The IRS furthered the transition away from paper returns by providing electronic filing options for all of the major tax filing categories, and by 2011, the electronic filing rate for individual income tax returns was 78 percent and continued

[10] A high-income nonfiler is any nonfiler with total income greater than or equal to $100,000.
[11] TIGTA, 2020. "High-Income Nonfilers Owing Billions of Dollars Are Note Being Worked by the Internal Revenue Service," 2020–30–015. Since 2020, the IRS has committed to a new strategy for handling non-filing cases and aims to prioritize those involving high-income taxpayers (*see* Eric Hylton, "How the IRS Prioritizes Compliance Work on High-Income Non-Filers Through National and International Efforts," CL–20–08, IRS.)
[12] IRS estimates. For direct enforcement agents and associated staffing, the ROI is much higher. The IRS provides a range of ROI estimates for different types of activities, informed by how collections have risen historically across categories. These range from 2 to 11, and increase over time as new initiatives become more productive. IRS, 2020. "Congressional Budget Justification & Annual Performance Report and Plan." Publication 4450 (Rev. 2–2020).

to rise to 93 percent in 2019. For business returns, the electronic filing rate has more than doubled (from 33 percent to 70 percent) since 2011.

Enhanced electronic filing should help the IRS improve compliance in an efficient manner.[13] In addition to reducing processing burden, data from electronically filed returns are easier to match against data contained on third-party information returns, prior year's returns, and similarly situated returns to help identify the most productive tax returns to audit. This work can also help avoid unnecessary, costly and burdensome audits of compliant taxpayers. Yet, tax compliance has not improved. This is because the IRS operates outdated systems and lacks the ability to fully take advantage of the benefits of more modern technology due to its resource constraints. Further, noncompliance has been exacerbated by enhanced opportunities to shield income from tax liability, and even from audits. These opportunities are particularly available for those in the top end of the income distribution who can avoid taxes through sophisticated strategies such as offshoring, creating complex partnership structures, or moving taxable assets into the crypto economy.[14]

Figure 3: Electronic Filing Rates, CY 2011–2020



A. Consequences of Technology Shortfalls

Due in part to the IRS's reliance on outdated technological platforms, the compliance benefits of the transition to electronic tax return filing have yet to be fully realized. Without adequate technology, the IRS is unable to make use of 21st century data analytic approaches to verify the accuracy of taxpayer filings.

The IRS's core tax processing system for over 150 million individual tax returns and $1.2 trillion in annual revenue—known as Individual Master File (IMF)—is written in programming languages that date back to more than half a century ago, making IMF among the oldest IT systems in the Federal Government.[15] Designed in 1962, IMF is one of the highest risk systems in the Federal Government, exposing a major weakness to the IRS's ability to administer and collect taxes. (The system for processing business tax returns is similarly antiquated.) Annual changes have been made to the system since its development to address tax code changes and to improve processes and, where possible, to update the underlying hardware. The result today is decades of tax law written in a programming language that is no longer taught, a data platform that is highly complex to maintain, and an outdated system

[13] GAO, 2019. "Multiple Strategies are Needed to Reduce Noncompliance: Statement of James R. McTigue, Jr., Director, Strategic Issues."

[14] The difficulty of tracking down offshore income is why some countries have adopted amnesty agreements that incentivize individual taxpayers to voluntarily disclose foreign wealth. These tend to increase tax revenue, reflecting a large gap between true taxable income and what is taxed. Langenmayr, Dominika, 2017. "Voluntary Disclosure of Evaded Taxes—Increasing Revenue, or Increasing Incentives to Evade?" Journal of Public Economics, 151: 110–125.

[15] GAO, 2019. "IRS Needs to Take Additional Actions to Address Significant Risks to Tax Processing," GAO–18–298.

with a limited number of employees supporting it—about half of whom are eligible to retire.

The IRS's legacy computing infrastructure cannot keep pace with the preferences of today's taxpayers for instantaneous data access, real-time interactions, and other customer-centric services. The cost to operate the IRS's current technology ecosystem continues to increase as well. The GAO has pointed out that the use of such an antiquated systems is more costly for the IRS than replacing with modern technology since "procurement and operating costs associated with this [programming] language will steadily rise, because fewer people with the proper skill sets are available to support [it]."[16] Outdated technology is a problem that extends beyond the 1960s Master File architecture. As of the end of 2020, 30 percent of software in use was "aged," meaning behind the most up-to-date version.[17]

Without the resources to modernize its underlying technological infrastructure the IRS is required to layer new IT systems on top of an obsolete base infrastructure.[18] The result is a patchwork approach that poses a threat to the stability of the tax system. As the National Taxpayer Advocate warned, "By analogy, the IRS has erected a 50-story office building on top of a creaky, 60-year-old foundation, and it is adding a few more floors each year. There are inherent limitations on the functionality of a 60-year-old infrastructure, and at some point, the entire edifice is likely to collapse."[19] To illustrate the danger, in the peak of the 2017 tax filing season, the IRS system crashed on the day of the filing deadline and forced a last-minute national Federal tax filing extension.[20] An added risk exposure caused by outdated technology is that it is ill-suited to meet new and expanding challenges. The IRS defends against approximately 1.4 billion sophisticated cyberattacks annually as criminals seek access to a significant volume of sensitive taxpayer data which would be better protected by more modern infrastructure.[21]

The limitations of outdated technology are well understood by Treasury and the IRS. The Taxpayer First Act of 2019 included a push to modernize information technology and move toward rebuilding IRS computer systems and implementing machine learning approaches to help give tax enforcement agents a clearer picture of the most suspect filers.[22] The ability to make progress on these efforts will be dependent on a sustained, timely multi-year budget commitment to cover the large fixed costs associated with transitioning away from legacy systems toward a modern, integrated platform.

In addition to hindering compliance efforts, IRS technological deficiencies have broad consequences for taxpayer service as well. The National Taxpayer Advocate reports that the IRS has struggled to provide adequate and reliable customer service. For example, the IRS had the resources to answer only 29 percent of the 100 million telephone calls received in FY 2019, and during many months of the COVID–19 pandemic, the combination of resource constraints and a shift to remote operations further complicated service efforts and reduced service levels.[23]

B. Budget Shortfalls Worsening over Time, Leading to a Decline in Enforcement Activity

The magnitude of the U.S. tax gap is the byproduct of many factors, including long-term IRS resource constraints. Since the early 2000s, the IRS budget as a share of GDP has been trending downward.[24] This decline masks the severity of the funding shortfall because the pressure for enforcement resources due to a growth in sophisticated evasion opportunities is rising even more rapidly than GDP. Examples of advanced evasion techniques include the use of foreign bank accounts to shield income from IRS scrutiny and the adoption of international, intra-company dealings that

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[16] *Ibid.*

[17] IRS, 2021. "Information Technology Annual Key Insights Report." Publication 5453 (3–2021).

[18] IRS, 2021. "IRS, Treasury Disburse 25 Million More Economic Impact Payments Under the American Rescue Plan," IR–2021–77.

[19] National Taxpayer Advocate, 2018. "Annual Report to Congress 2018."

[20] Rappeport, Alan. "IRS Website Crashes on Tax Day as Millions Tried to File Returns," *New York Times,* April 17, 2018.

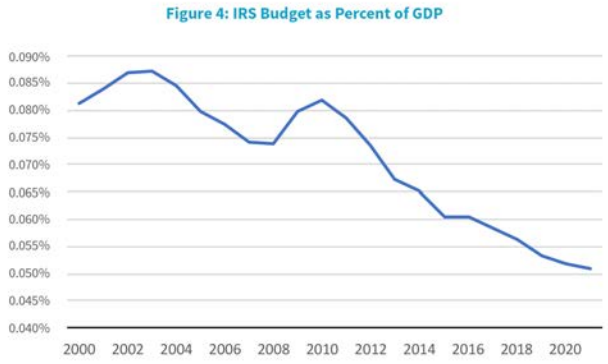
[21] Treasury, 2019. "Treasury Announces IRS Integrated Modernization Business Plan Promoting Cost Efficiency, Improved Taxpayer Service, and Protection."

[22] IRS, 2018. "Criminal Investigation Annual Report 2018," IRS–2018–219.

[23] *See* National Taxpayer Advocate, 2019. "Annual Report to Congress 2019"; National Taxpayer Advocate, 2020. "Annual Report to Congress 2020."

[24] IRS Statistics of Income, 2019. "Table 31: Collection Costs, Personnel, and U.S. Population," Databook.

shift income solely for tax purposes but can be made to appear legitimate in ways challenging for the IRS to detect.



Over this same time period, there has been a rise in complex business structures, such as partnerships, which also require significant efforts by IRS agents to obtain a complete understanding of interrelated business activities. Partnership income as a share of total income grew from less than 5 percent to more than 35 percent since 1990. More than 4.2 million partnership returns were filed in calendar year 2018, which is more than double the number of corporate returns filed the same year; however, the IRS audited only 140 of these returns.[25] Examining these returns is resource-intensive for the IRS because many partnerships use tiered organizational structures where multiple levels of domestic and sometimes foreign business entities combine to obscure the ultimate beneficiaries of the business operations. Some recent research suggests that 30 percent of partnership income cannot unambiguously be traced to the ultimate owner.[26]

The IRS, like all Federal agencies, is best suited to provide the services Americans deserve when it has the resources it needs to do so. At present, IRS funding deficiencies have directly resulted in an inability for the IRS to meet its mission of administering a fair and effective tax system.

Despite preexisting needs to modernize outdated systems and to detect increasingly complex evasion, the last decade shows a decrease—rather than an increase—in IRS resources. In real terms, the IRS's overall budget declined by 18.5 percent between FY 2010 and FY 2021.[27] The IRS's enforcement budget decreased by 15 percent over this time period, leading to a 20 percent decline in the IRS workforce.[28] These losses have been most significant for revenue officers who collect taxes (50 percent decrease) and revenue agents who audit complex returns (35 percent decrease). Today, the IRS has fewer auditors than at any time since World War II.[29] As experienced employees have retired, the IRS has been unable to replace departing workers with new revenue officers and with agents of comparable training and skills necessary to pursue the most complicated noncompliance cases.

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[25] This translates to an audit rate of less than 0.00004 percent. Similarly, just 397 of the 4.8 million S-corporation returns were audited. IRS Statistics of Income, 2019. "Table 17a: Examination Coverage and Recommended Additional Tax After Examination, by Type and Size of Return," IRS Databook.

[26] Cooper, Michael et al., 2016. "Business in the United States: Who Owns It, and How Much Tax Do They Pay?" Tax Policy and the Economy, 30(1): 91–128.

[27] IRS Statistics of Income, 2019. "Table 31: Collection Costs, Personnel, and US Population," IRS Databook; Congressional Research Service, 2021. "Internal Revenue Service Appropriations, FY2021."

[28] IRS Statistics of Income, 2010. "Table 28: Costs Incurred by Budget Activity," IRS Databook. IRS Statistics of Income, 2019. "Table 31: Collection Costs, Personnel, and US Population," IRS Databook.

[29] Sarin, Natasha and Lawrence Summers, 2019. "Shrinking the Tax Gap: Approaches and Revenue Potential," *Tax Notes Federal,* 18 November.

Consequently, the share of audited returns has declined by nearly 45 percent between 2010–2018.[30] There has also been a contemporaneous steep decline in audit rates across all filing categories. The share of corporate income tax, individual income tax, estate tax, and employment tax returns examined by auditors have all dropped in the last decade.

Table 2: Audit Rates, 2010 vs. 2018

Decline in Audit Rates by Filer Category

Filer Category	Percent Audited		Percent Decline
	2010	2018	
All Filers	0.93%	0.51%	−45.39%
Individuals	1.11%	0.59%	−46.30%
EITC recipients	2.39%	1.41%	−41.10%
With annual income over $1 million	8.36%	3.23%	−61.35%
$1 million–$ 5 million	6.67%	2.21%	−66.87%
$5 million–$ 10 million	11.55%	4.21%	−63.55%
$ 10 million +	18.38%	6.66%	−63.76%
Corporations	1.39%	0.88%	−36.54%
With assets over $20 billion	97.99%	49.29%	−49.70%
Employment	0.21%	0.14%	−33.63%
Estates	10.12%	8.60%	−15.01%
With assets over $5 million	24.31%	18.71%	−23.07%

Source: IRS Statistics of Income Databook. Audit rates by annual income are imputed from Table 9b; all other data are from Table 9a.

The decreases in audit rates are most pronounced for highly complex audits performed by experienced agents. Among individual taxpayers, audits of taxpayers with income over $1 million have fallen by over 60 percent between 2010–2018, with the audit rate decreasing from 8.4 percent to 3.2 percent.[31]

Audit coverage for large corporations has been cut in half over the last decade. as coverage for companies with $20 billion or more in assets decreased from 98 percent in FY 2010 to around 50 percent.[32] This is the result of staff attrition and budget stringency, which both diminish the resources that the IRS can dedicate to auditing high-income taxpayers and large corporations. During the past 10-year period, global high wealth examinations have taken roughly 2 years on average to complete and have averaged around 284 hours per return. The same is true for partnerships, where audits average around 333 hours per return. In contrast, routine field audits of less complex taxpayers average approximately 40 hours per return.[33]

In order for the IRS to appropriately focus enforcement scrutiny on high-income taxpayers and the businesses they own—which research has shown is a primary source of the tax gap—its budget must be replenished. IRS agents cannot simply be assigned to global high wealth, partnership, or large and complex business examinations without the requisite skills, training, and experience to analyze returns that

[30] IRS Statistics of Income, 2019. "Table 17b: Examination Coverage: Recommended and Average Recommended Additional Tax After Examination," IRS Databook. IRS Statistics of Income, 2010. "Table 9a: Examination Coverage: Recommended and Average Recommended Additional Tax After Examination," IRS Databook.
[31] *Ibid.*
[32] *Ibid.*
[33] IRS data.

are highly complex: For large corporations, the average number of pages per tax filing has risen from slightly under 4,000 to nearly 6,000 since FY 2012.[34]

The vast majority of taxpayers timely file their returns and pay the tax liabilities they owe. However, declining examination coverage has real consequences. There is a direct correlation between the number of audits that the IRS is able to perform and the revenue that the IRS collects from examinations.[35] In addition, if certain compliant taxpayers come to believe that there is little to lose or much to gain from underpaying tax liabilities, overall compliance levels will decline.[36] Visible enforcement efforts can help keep taxpayers compliant.

Falling revenue due to fewer audits imposes added real costs passed on to non-evaders. In the long run, either taxes must be raised on compliers or government expenditures must be limited. The lack of enforcement thus leads to a de facto punitive tax on compliant taxpayers as those who pay their fair share will have their taxes increased or government services reduced because evaders are not paying. The costs can be particularly high for compliant direct competitors of tax evaders.[37] Evasion opportunities essentially impose an even greater tax on compliant taxpayers because direct competitor businesses who abide by the tax laws are put at a competitive disadvantage. As taxes rise to meet revenue needs, this disadvantage is made more pronounced since only law-abiding taxpayers bear the burden of tax changes.

The consequences of these shortfalls have been exacerbated by expanding responsibility, as these consequential budget cuts have been matched with calls for the IRS to take on new functions. While these new functions are related to the IRS' core mission of tax administration, the increased workload spreads limited resources even more thinly. Indeed, many parts of the Affordable Care Act are administered through the IRS. And recently, the IRS has been pivotal in facilitating support for American families in the COVID–19 pandemic: For example, it has administered three rounds of Economic Impact Payments, most recently sending out over 160 million payments totaling nearly $400 billion within weeks of the American Rescue Plan's passage.[38] The IRS also has been charged by Congress with providing periodic advance payments of the Child Tax Credit for the first time in history, and proposals in the American Families Plan call on the IRS to administer credits that provide expanded support for families, childcare, and low-income individuals in the coming years.

C. Inequities in Tax Enforcement

Although the tax code redistributes income in a way that mitigates racial and income inequality, it also can function in ways that exacerbate it.[39] Indeed, research has highlighted ways in which aspects of tax policy can advantage upper-income taxpayers, while also identifying aspects that burden low-income individuals. In addition, scholars have increasingly focused on aspects of the tax code that disadvantage Black and Hispanic families in particular.[40]

IRS enforcement efforts can have similar effects. Recently, a stream of research has begun to identify disparities in tax enforcement activities.[41] Historically, this inquiry has been complicated by the absence of data on taxpayers' race or ethnicity.[42]

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[34] *Ibid.*

[35] Sarin, Natasha and Lawrence Summers, 2019. "Shrinking the Tax Gap: Approaches and Revenue Potential," *Tax Notes Federal,* 18 November.

[36] *Ibid.*

[37] Slemrod, Joel, 2007. "Cheating Ourselves: The Economics of Tax Evasion," *Journal of Economic Perspectives* 21, 1 (2007): 25–48.

[38] Treasury, 2021. "More than 1.1 Million Additional Economic Impact Payments Disbursed Under the American Rescue Plan; Payments Total Approximately 164 Million," IR–2021–103, 5 May.

[39] For example, until recently, the vast majority of children living in poverty were ineligible for the Child Tax Credit (CTC). Because of the concentration of poverty in minority communities, this meant that although three-quarters of white and Asian children were eligible for the full CTC, only about half of Black and Hispanic children were. Goldin, Jacob and Katherine Michelmore. "Who Benefits from the Child Tax Credit?" *National Tax Journal,* forthcoming. The Biden Administration's reforms are focused on redressing this inequity.

[40] Brown, Dorothy A. "The Whiteness of Wealth: How the Tax System Impoverishes Black Americans—And How We Can Fix It." Crown Publishing Group, New York City, 2021.

[41] Work by former IRS economist Kim Bloomquist points out that the five counties with the highest audit rates are predominantly African-American, rural counties in the South. Bloomquist, Kim M. "Regional Bias in IRS Audit Selection." *Tax Notes Federal,* March 4th. A number of other promising research projects are underway.

[42] Bearer-Friend, Jeremy, 2019. "Should the IRS Know Your Race? The Challenge of Color-blind Tax Data." Tax L. Rev. 73 (2019): 1.

The Biden administration recently launched an Equitable Data Working Group that seeks to address these data limitations across Federal datasets. At the same time, the Treasury Department is currently undertaking research to study the relationship between the tax code and racial inequities. This multi-year project will require close engagement between Federal agencies and those in the research and advocacy communities.

Over the last decade, a reduction in resources available to the IRS exacerbated inequities in predictable ways. In particular, diminished resources made it difficult to maintain a cadre of the most specialized auditors, which in turn depressed audits rates for high-income taxpayers relative to those in the lower part of the income distribution. Indeed, although audits of those claiming the Earned Income Tax Credit (EITC), have fallen by around 40 percent since 2010, income tax audits of those earning $10 million or more annually have fallen by closer to 65 percent (See Table 3). While it is true that audit rates generally rise with income levels so that high earners are audited with a greater probability than those of low or moderate income, the level differences mask a significant shift in the trend.

Inequities in enforcement are not solely the result of a reduction in the number of audits of high-income taxpayers. Rules and regulations governing tax procedures can advantage well-resourced and corporate taxpayers who have access to tax experts in ways lower-income taxpayers do not. For instance, wealthy taxpayers often rely on tax opinions provided by advisors to avoid penalties and have their representatives negotiate terms to obtain more favorable outcomes.[43]

It is important to note that the President's compliance proposals are designed to ameliorate existing inequities by focusing on high-end evasion. Audit rates will not rise relative to recent years for those with less than $400,000 in actual income. This focus is justified by the composition of the tax gap, which accrues disproportionately to those at the top of the distribution, who earn income in opaque categories like partnership and proprietorship income, where misreporting rates are high. While the impact on racial disparities from future enforcement efforts remains to be seen and will be the byproduct of a broader set of policy initiatives, the Biden administration's commitment to racial equity was a key factor in the design of the current proposal.

For these reasons, investments in tax compliance do more than raise revenue to fund necessary investments or improve our fiscal position. They also work to address inequities by increasing the share of IRS enforcement attention that is focused on high-income noncompliers. Further, improvements in taxpayer services and other enhancements to tax administration such as the tighter regulation of tax preparers can decrease disparities in the treatment of different groups of taxpayers.

IV. The President's Compliance Proposals

The President's proposals would overhaul tax administration in the United States to create a more equitable tax regime. These proposals, taken as a whole, would generate revenue from taxes that are owed but not paid and through improved voluntary compliance. Increased funding for the IRS would also improve how taxpayers are served by the IRS—making sure that all taxpayers are able to take advantage of the tax benefits to which they are entitled and are able to communicate effectively and efficiently with the IRS when questions arise.

The compliance initiative has several elements, including:

- Increasing the resources of the IRS to pursue noncompliant taxpayers and better serve the vast majority who are fully compliant;
- Leveraging information that financial institutions already collect to shed light on those taxpayers who misreport income derived from opaque categories;
- Overhauling antiquated technology to help IRS leverage 21st century data analytic tools; and
- Regulating paid tax preparers and increasing penalties for those who those who intentionally commit malfeasance.

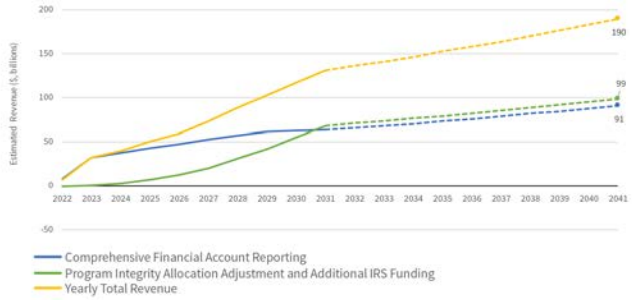
While it will take time and substantial effort to achieve these goals, even modest progress would translate into a substantial increase in revenue. Treasury's Office of Tax Analysis estimate that over the next decade, these changes would shrink the

[43] Blank, Joshua D., and Ari D. Glogower, 2021. "Progressive Tax Procedure." 96 New York University Law Review, forthcoming.

tax gap by about 10 percent, raising $700 billion in additional tax collections over the next 10 years net of investments. The revenue raised is even larger in the second decade after enactment at about $1.6 trillion. Revenue raised is backloaded in part because investments in the IRS often take several years to reach their ultimate payoff.

Figure 5: Revenue Raised Each Year

IRS Compliance Proposals, FY 2022 - 2041 ($, billions)



NOTE: Estimates outside the 10-year budget window are subject to greater uncertainty which is reflected through the dotted line.

In addition to raising substantial revenue, investments in tax compliance would improve the efficiency and fairness of the tax code. Evasion imposes economic distortions because the resources taxpayers expend to implement and hide income from tax authorities create no social benefits. Tax evasion also can shift economic activity into certain areas like proprietorship or cash-based businesses due to their evasion advantage. In addition, the same tax rates raise more revenue once evasion is made more difficult, and economic distortions caused by disparate tax treatments of honest versus evasive businesses, among other examples, would be decreased. Further, the tax code will be fairer when it no longer benefits opaque sources of income relative to wage labor. In sum, effectively tackling tax evasion can decrease the amount of resources expended on underpaying tax liabilities, limit distortions, and encourage more socially responsible behavior.

The uneven distribution of the tax gap implies that evasion contributes to after-tax income inequality. Prior empirical evidence demonstrates that the tax gap can be tied disproportionately to people in the top end of the income distribution,[44] and recent research emphasizes the importance that income misreporting has for understanding income inequality trends.[45] Further, asymmetric compliance rates between labor wage income and more opaque sources of income, especially for high-income earners, has important horizontal and vertical equity implications. As such, the fairness and progressivity of the tax code can be enhanced through more equal compliance rates that ensure those with high incomes pay what they owe.

A. Restoring IRS Resources

The first step in the President's efforts to restore IRS enforcement capability is a sustained, multi-year commitment to rebuilding the IRS. This involves spending nearly $80 billion on IRS priorities over the course of the decade including hiring new specialized enforcement staff, modernizing antiquated information technology, and investing in meaningful taxpayer service—including the implementation of the newly expanded credits aimed at providing support to American families. Importantly, the additional resources will go toward enforcement against those with the highest incomes, and audit rates will not rise relative to recent years for those earning less than $400,000 in actual income.

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[44] *See, e.g.,* Alm, James and Keith Finlay, 2013. "Who Benefits from Tax Evasion?" Economic Analysis & Policy, 43(2). This is true outside of the United States as well: recent evidence in Scandinavia based on the Panama Papers revelations finds that although 3 percent of personal taxes are evaded on average, this figure rises close to 30 percent in the top 0.01 percent of the distribution. Annette Alstadsæter, Niels Johannesen, and Gabriel Zucman, "Tax Evasion and Tax Avoidance," *Journal of Public Economics* (under review).

[45] DeBacker, Jason et al., 2020. "Tax Noncompliance and Measures of Income Inequality," *Tax Notes Federal,* 17 February; and Johns, Andrew and Joel Slemrod, 2010. "The Distribution of Income Tax Noncompliance," *National Tax Journal,* 63(3).

The President's proposal includes two components: a dedicated stream of mandatory funds ($72.5 billion over a decade) and a program integrity allocation ($6.7 billion over a decade).[46] These mechanisms provide for a sustained, multi-year commitment to revitalizing the IRS that will give the agency the certainty it needs to rebuild.

The IRS proposal includes year-by-year estimates of the additional resources that will be directed toward the agency as well as the specific activities that these resources would support. The design ensures that the IRS is able to absorb and usefully deploy additional resources over the entire 10-year horizon and keeps budget growth manageable at around 10 percent per year.

[46] The congressional budget resolution allows for additional appropriations to the IRS in the form of be multi-year commitments to fund "program integrity" activities that are estimated to save more than they cost, as is the case with IRS enforcement efforts.

Table 3: IRS Proposal and Revenue Raised, 2022–2031

Return on Investing in the IRS
(inflation adjusted)

$M	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	Total	Return Per Dollar Invested
Mandatory												
Cost	1,142	2,095	3,035	4,174	5,563	7,189	9,203	11,405	14,115	14,546	72,467	
FTE	*2,642*	*6,729*	*13,326*	*20,874*	*29,783*	*39,803*	*51,770*	*64,770*	*80,349*	*81,743*		
Direct Revenue	–	631	3,098	6,959	12,435	19,758	29,903	40,730	53,721	63,780	231,015	3.2
Revenue Protected	–	–	214	603	1,402	2,584	4,178	6,211	8,532	11,157	34,881	
Direct & Protected Revenue	–	631	3,312	7,562	13,837	22,342	34,081	46,941	62,253	74,937	265,896	3.7
Program Integrity Cap Adjustment												
Cost	417	647	643	660	677	694	712	731	750	769	6,700	
FTE	*2,555*	*5,109*	*5,109*	*5,109*	*5,109*	*5,109*	*5,109*	*5,109*	*5,109*	*5,109*		
Direct Revenue	334	1,690	2,826	3,538	4,099	4,565	4,954	5,279	5,554	5,794	38,633	5.8
Revenue Protected	–	168	339	517	795	1,324	1,641	1,964	2,242	2,657	11,647	
Direct & Protected Revenue	334	1,858	3,165	4,055	4,894	5,889	6,595	7,243	7,796	8,451	50,280	7.5
Mandatory and Cap Adjustment Combined												
Cost	1,559	2,742	3,678	4,834	6,240	7,883	9,915	12,136	14,865	15,315	79,167	
FTE	*5,197*	*11,838*	*18,435*	*25,983*	*34,892*	*44,912*	*56,879*	*69,879*	*85,458*	*86,852*		
Direct Revenue	334	2,321	5,924	10,497	16,534	24,323	34,857	46,009	59,275	69,574	269,648	3.4
Revenue Protected	–	168	553	1,120	2,197	3,908	5,819	8,175	10,774	13,814	46,528	
Direct & Protected Revenue	334	2,489	6,477	11,617	18,731	28,231	40,676	54,184	70,049	83,388	316,176	4.0

The $6.7 billion program integrity allocation allows for increases in base discretionary funding for boosting effective enforcement of taxpayer compliance. This effort will support the hiring and retention of at least 5,000 new enforcement personnel.

The mandatory funds are allocated over a 10-year horizon. They provide enforcement resources, including a significant investment in revitalizing the IRS's examination of large corporations, partnerships, and global high-wealth and high-income individuals. Mandatory funds are also directed toward other important IRS priorities. For example, nearly $6 billion is dedicated to IT modernization. Modernization funding will allow the IRS to address core technology challenges and transform IRS provision of meaningful taxpayer services and tax enforcement efforts. Tax processing technology today is supported by an inefficient and inflexible batch processing architecture that delays the provision of tax administration data to IRS systems, employees, and taxpayers. Modernized technology will allow the IRS to make data more easily available for service and enforcement purposes and to move toward near real-time tax processing. The existing case management system supported by more than 60 different components could be integrated to provide a more comprehensive view of enforcement case information and taxpayer data and real-time tax processing. The result would be a more interactive tax processing experience that will allow for an improved taxpayer experience and for the IRS to focus resources on redressing noncompliance.

Additional IT tools will help support a staff capable of deploying new analytical techniques; investing in developing machine learning capabilities will enable the IRS to leverage the information it collects to better identify tax returns for compliance review. The proposed IT investment includes $4.5 billion to implement a new information reporting regime. New resources would also support efforts to meet imminent threats to the security of the tax system, like cyberattacks.

Revitalizing the IRS requires more than building up the IRS's enforcement efforts and technological systems. Revitalization also demands a renewed commitment to meaningful taxpayer service. The President's proposal will enable taxpayers to communicate with the IRS securely and efficiently, and the IRS's new workforce would include additional dedicated customer service representatives ready to assist taxpayers as they navigate newly expanded programs like the Child Tax Credit, the Child and Dependent Care Tax Credit, and the Earned Income Tax Credit.

Because the expansion in the IRS's budget is phased in over a 10-year horizon, each year the IRS's workforce should grow by no more than a manageable 15 percent. By the end of the decade, however, the IRS's budget would be roughly 40 percent above 2011 levels in real terms as a result of this proposal.[47] This is a sizable increase, but a necessary one given that the IRS's responsibilities have grown dramatically over the intervening period. Yet even with this increase, the IRS budget would still not return to early 1990s levels as a share of gross collections.

The IRS estimates the marginal return on investment (ROI) for most of its enforcement activity based on historical tax enforcement data. Average ROIs for the mandatory and program integrity allocations are shown in Table 3 above. The Office of Tax Analysis' revenue estimate for the IRS funding proposal is projected based on these ROI estimates. Total additional revenue generated from the $80 billion increase in the IRS budget over 10 years is estimated to be around $320 billion during this horizon, which suggests roughly a 4-to-1 ROI.

These numbers are conservative because IRS ROI estimates are only available for the subset of enforcement investments, and not technology or service improvements that are likely to improve compliance. As a result, revenue estimates do not take into account increases in enforcement efficiency or taxpayer compliance that will arise from non-enforcement investments such as the benefits of widespread use of machine learning technologies. Further, these estimates do not account for increases in voluntary compliance attributable to improvements in taxpayer service. For example, when taxpayer questions are answered in a timely manner, taxes tend to be paid more accurately plus the fact that an effective system of tax administration increases taxpayer trust and compliance.[48]

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[47] This calculation assumes that the IRS discretionary budget over time will approximately resemble the real resource levels indicated by the FY 2022 discretionary budget request.

[48] *See, e.g.,* Williamson, Vanessa S. "Read My Lips: Why Americans are Proud to Pay Taxes." Princeton University Press, 2017.

Further, because standard IRS methodologies focus on enforcement cases and the associated revenue and costs, they are not capable of arriving at an ROI for large-scale IT investments. Although researchers understand that the potential of better IRS technology to improve collections efforts is sizable, these gains are difficult to attribute in revenue estimation.

Moreover, these estimates do not take into account the deterrent effects associated with different types of enforcement activities which are generally considered to be quite significant.[49] More recent empirical work provides a way to start to try and understand the importance of the indirect effects in understanding the revenue potential of compliance initiatives. A recent peer-reviewed study found, for example, that increased income reported in the 5 to 8 years following a random audit is about 1.5 times the audit revenue.[50] Another peer-reviewed study noted that in-person collection visits raise as much revenue from firms that share a tax preparer with the visited firm as they do from the visited firm itself.[51] Although more research is needed to arrive at a better understanding of the magnitude of deterrent effects, revenue estimates that fail to include noncompliance deterrence are conservatively low.

For the purposes of the Office of Tax Analysis' estimation, revenue is counted when it accrues to the IRS, and a collection stream for enforcement revenue is built into these estimates: For example, even for an audit closed in FY 2022 with adjustments, collections will be realized over time. This is part of the reason why revenue from this proposal is backloaded in the traditional 10-year budget window. Further, estimates incorporate the fact that new hires take several years to reach their full potential. Revenue estimates also assume a declining marginal return for enforcement activity as the level of enforcement rises. Revenue generated reaches its steady state shortly after the end of the 10-year horizon, and the backloaded nature of additional tax collections results in a second-decade revenue estimate that is more than twice as large as the first (See Figure 5).

B. Increased Information Reporting

The second step in the compliance agenda involves shining light on opaque income streams, including proprietorship and partnership business income. Bolstering information reporting is regarded by the IRS and GAO as one of the best ways to increase the overall compliance rate,[52] and existing empirical evidence confirms that introducing third party reporting requirements is effective.[53]

Previous changes to information reporting shed light on the significant potential of such efforts but also on pitfalls that can arise when reporting requirements are imprecisely designed. It is important to implement comprehensive information reporting regimes, as partial reforms can simply shift tax evasion into other areas.[54] Fur-

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[49] A longstanding Treasury estimate suggests that the deterrent effects of compliance activities are likely at least three times as large as the direct effects. IRS, 2018. "Budget in Brief FY 2019."

[50] Jason DeBacker et al., 2018. "Once Bitten, Twice Shy? The Lasting Impact of Enforcement on Tax Compliance," *The Journal of Law and Economics,* 61, 1 (2018).

[51] Boning, William, et al., 2020. "Heard it through the grapevine: The direct and network effects of a tax enforcement field experiment on firms." *Journal of Public Economics* 190 (2020): 104261.

[52] GAO, 2019. "Multiple Strategies are Needed to Reduce Noncompliance: Statement of James R. McTigue, Jr., Director, Strategic Issues," GAO–19–558T, Washington, DC: GAO, 2019; and IRS, 2019. "Understanding the Tax Gap and Taxpayer Noncompliance, Written Testimony of Dr. Benjamin D. Herndon, Chief Research and Analytics Officer, Internal Revenue Service, Before the House Ways and Means Committee on the Tax Gap."

[53] Pomeranz, Dina, 2015. "No Taxation Without Information: Deterrence and Self-Enforcement in the Value Added Tax." *American Economic Review,* 105(8); Phillips, Mark D., 2014. "Individual Income Tax Compliance and Information Reporting: What Do the US Data Show?" *National Tax Journal,* 67(3); Marchase, Carla, 2009. "Rewarding the Consumer for Curbing the Evasion of Commodity Taxes," Public Finance Analysis, 65(4); Johannesen, Niels, 2014. "Tax Evasion and Swiss Bank Deposits," *Journal of Public Economics,* 111; Adhikari, Bibek et al., 2016. "Taxpayer Responses to Third-Party Income Reporting: Evidence From a Natural Experiment in the Taxicab Industry," IRS Research Bulletin, 6th Annual Joint Research Conference on Tax Administration, IRS and the Urban-Brookings Tax Policy Center; Naritomi, Joana, 2019. "Consumers as Tax Auditors," *American Economic Review,* 109(9). (*See also* Kleven, Henrik et al., 2011. "Unwilling or Unable to Cheat? Evidence from a Tax Audit Experiment in Denmark," *Econometrica,* 79(3), finding that the tax evasion rate is close to zero for income subject to third-party reporting, but substantial for self-reported income.)

[54] For example, the introduction of Form 1099–K provided the IRS and taxpayers with information about businesses' sales by payment card and other electronic means. As a result, taxpayers increased reported receipts by up to 24 percent once they began to believe that the IRS could conceivably verify gross receipts. However, many business taxpayers appeared to offset

ther, financial institutions house a lot of valuable information, and indeed already provide third-party reports to the IRS. Leveraging this information—rather than introducing new requirements for taxpayers[55]—is a proven way to improve compliance.[56]

The President's proposal requires information reporting on financial accounts to increase the visibility of gross receipts and expenses to the IRS. Today, business income is subject to limited information reporting. Current reporting of gross receipts exists for only certain types of revenue, and there is no information reporting on deductible expenses. This is why the tax gap for partnership, S-corporation, and proprietorship income is estimated at around $200 billion annually with the net misreporting percentage for certain income categories exceeding 50 percent.

Third party information reporting is already provided on primary income streams for the vast majority of Americans, such as wage, pension, and unemployment income. The President's proposal would help make tax administration more equitable by subjecting financial flows, especially those that accrue disproportionately to those at the top of the income distribution, to third-party reporting as well.

The new reporting regime would build from the framework of the Form 1099–INT reports that taxpayers already receive from financial institutions when they earn more than $10 in interest from a bank, brokerage, or other financial institution. Financial institutions would simply report additional data on the financial accounts of these existing information returns. Specifically, the annual return would report gross inflows and outflows on all business and personal accounts from financial institutions, including bank, loan, and investment accounts but carve out exceptions for accounts below a low de minimis gross flow threshold.[57]

Other accounts that are similarly situated to financial institution accounts would also be covered under this new reporting regime—for example, payment settlement entities would also be required to report gross receipts and gross purchases. The reporting regime would also cover foreign financial institutions and crypto asset exchanges and custodians.

These new reporting requirements would come with no additional reconciliation requirement for taxpayers. For already compliant taxpayers, the only effect of this regime is to provide easy access to summary information on financial accounts and to decrease the likelihood of costly "no fault" examinations once the IRS is able to better target its enforcement efforts. For noncompliant taxpayers, this regime would encourage voluntary compliance as evaders realize that the risk of evasion being detected has risen noticeably.

To arrive at a revenue estimate for the impact of a comprehensive information reporting regime, the Office of Tax Analysis began with an estimate of the tax gap for business income which included Schedule C proprietorship income, Schedule E rent and pass-through income, and small corporation income as well as the portion of the employment tax gap associated with business incomes. This tax gap estimate was then reduced to reflect the expected increase in voluntary compliance once taxpayers realize that the IRS has a lens into business income. The revenue estimate added two assumptions: first, a reduction in the steady state share of the tax gap

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this change with simultaneously increased reported expenses. Slemrod, Joel et al., 2017, "Does Credit Card Information Reporting Improve Small-Business Tax Compliance?" *Journal of Public Economics,* 149. *See also* Adhikari, Bibek et al., 2020. "Information Reporting and Tax Compliance," AEA Papers and Proceedings, 110.

[55] As part of the Affordable Care Act, a new provision was introduced which would have required businesses to send Form 1099 information returns for all purchases of goods and services over $600. It was set to go into effect in 2012 but repealed 6 months prior to enactment because of a concern about the burden imposed on small businesses. *National Taxpayer Advocate,* 2010. "Fiscal Year 2011 Objectives Report to Congress."

[56] For example, in the international sphere, the Foreign Account Tax Compliance Act (FATCA) was enacted in 2010 to help combat tax evasion by those with offshore accounts. Although it is difficult to draw full conclusions given the nascency of these efforts, research suggests that financial institutions play an important role in providing information to the IRS that encourages increased compliance. De Simone, Lisa, Rebecca Lester, and Kevin Markle, 2020. "Transparency and Tax Evasion: Evidence from the Foreign Account Tax Compliance Act (FATCA)." *Journal of Accounting Research* 58(1). This is in part attributable to amnesty programs that were implemented around the same time as new reporting requirements and precipitated a significant increase in self-reported foreign dealings. Johannesen, Niels, et al., 2020. "Taxing Hidden Wealth: the Consequences of US Enforcement Initiatives on Evasive Foreign Accounts," *American Economic Journal: Economic Policy* 12(3).

[57] The proposal preserves significant flexibility for the Secretary and the IRS to design the new reporting requirements in the way that will be most effective for tax compliance efforts.

due to increased voluntary compliance as taxpayers react to increased information reporting; and second, a gradual increase of voluntary compliance that phases in over time.

The revenue estimates assume that the bank reporting proposal will become effective for tax year 2023, building in implementation time for the IRS and for financial institutions. The administration would concurrently seek out ways to reduce any new burden on financial institutions associated with this information reporting requirement.

This additional information reporting would also enhance the effectiveness of enforcement measures, as it will provide a proxy measure for a taxpayer's potential income position, and suspect account flows could help the IRS better target its enforcement activities. This would benefit compliant taxpayers, whose risk of costly no-fault audits would decrease as the IRS better targets enforcement actions.

According to the Office of Tax Analysis, the increase in compliance that would result from this new reporting regime is estimated to raise $460 billion over the next decade.

Challenges of Cash and Virtual Currencies

For a new information reporting regime to shed light on previously opaque income sources effectively, it is imperative to prevent business income from being shielded from reporting requirements. This is why the new Form 1099 reports would also be required from payment services providers so that businesses cannot shift out of traditional financial institutions to other kinds of platforms and avoid making their income visible to the IRS.

Another concern is that an information reporting regime will shift taxpayers toward a greater use of cash. Although information reporting may push some taxpayers to transact more in cash to avoid the reporting, it is unlikely that a substantial share of the business tax gap will move to cash-based transactions. Businesses already have incentives to use cash as much as possible to avoid detection via bank statements obtained in an audit, but there are practical barriers—such as security risks and the difficulty of spending large amounts of cash for certain transactions—to expanding the use of cash without depositing it in a bank account.

Still another significant concern is virtual currencies, which have grown to $2 trillion in market capitalization.[58] Cryptocurrency already poses a significant detection problem by facilitating illegal activity broadly including tax evasion.[59]

This is why the President's proposal includes additional resources for the IRS to address the growth of cryptoassets. Despite constituting a relatively small portion of business income today, cryptocurrency transactions are likely to rise in importance in the next decade, especially in the presence of a broad-based financial account reporting regime. Within the context of the new financial account reporting regime, cryptocurrencies and cryptoasset exchange accounts and payment service accounts that accept cryptocurrencies would be covered. Further, as with cash transactions, businesses that receive cryptoassets with a fair market value of more than $10,000 would also be reported on. Although cryptocurrency is a small share of current business transactions, such comprehensive reporting is necessary to minimize the incentives and opportunity to shift income out of the new information reporting regime.[60]

C. Other Compliance Proposals

The administration's compliance proposals include a number of other additional tools for the IRS that complement the transformational nature of the investments and information reporting regime discussed above.

For example, the proposal provides the IRS with the authority to regulate and establish minimum competency standards for all paid tax preparers.[61] Unregulated

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[58] Chavez-Dreyfuss, Gertrude. "Crypto Market Cap Surges to Record $2 Trillion, Bitcoin at $1.1 Trillion," Reuters, April 5, 2021.

[59] Early work suggested the significance of the challenges posed by the rise of virtual currencies: "To the extent that cryptocurrencies continue to gain momentum; we could reasonably expect tax evaders—who traditionally executed their tax-evasion techniques through the use of offshore bank accounts in tax-heaven jurisdictions—to opt out of traditional tax havens in favor of cryptocurrencies." *See, e.g.,* Marian, Omri, 2013. "Are Cryptocurrencies Super Tax Havens," *Michigan Law Review First Impressions,* 112(38).

[60] It is worth noting that the IRS has identified cryptocurrency transactions as an enforcement priority and recently included cryptocurrency reporting on the individual tax return, Form 1040.

[61] A previous initiative in 2010 launched by the IRS proposed requiring a basic competency exam and taking annual classes to stay abreast of tax changes; however, courts ruled that the

preparers submit more tax returns than all other preparers combined, and they often make costly mistakes that subject their customers to audits.[62] A recent GAO study shed light on the scope of this problem. During undercover visits to 19 randomly selected unregulated preparers, only two calculated taxpayers' refunds accurately.[63] The issues of unregulated tax preparers go beyond the quality of services provided. Some unregulated preparers enrich themselves by ascribing to themselves a portion of taxpayers' refunds; or they commit fraud while failing to sign returns (so called, "ghost preparers"), leaving the taxpayers who are audited without the ability to prove that fraudulent returns are the fault of unscrupulous preparers.[64] In addition to establishing standards for unregulated tax preparers, the President's proposal would include additional penalties for ghost preparers.

Other proposals identify opportunities in several areas to strengthen tax collection. An additional change would improve taxpayer information accuracy by permitting the IRS to require payment recipients to certify their taxpayer identification numbers (TINs) to payers who issue third-party information reports; another proposal imposes unpaid corporate tax liability on shareholders in specified tax shelter cases.

D. Interaction Between Compliance Initiatives

The increase in information reporting and the IRS's resources and enforcement tools are complementary, and both are essential ingredients to effective and equitable tax administration. For reporting to be most useful, the IRS needs the funding to understand and process the information it receives. For the IRS's funding to be best spent, the IRS needs more lenses into opaque sources of income.

To be effective in promoting accurate reporting of business income, the new financial account reporting regime would require a substantial expansion of the IRS's information technology and data analytic capacity. This funding is provided for with mandatory funds that are predesignated for implementing the new reporting regime.

Financial account reporting will also make underreported business income that has historically only been revealed at audit visible in some form to the IRS. Information on inflows and outflows can help the IRS select cases for enforcement activity and may make the audit process more efficient. Finally, the proposed enforcement funding, coupled with the improved visibility of business income, could increase the IRS's efficiency, facilitating the pursuit of a greater share of suspected evaders.

V. Conclusion

Over the last decade, and even prior, the IRS has lacked the resources it needs to enforce the tax laws and best serve taxpayers. This costs the government around 3 percent of GDP each year in owed but uncollected taxes. But it also decreases the progressivity of the tax code since the benefits of noncompliance accrue disproportionately to top earners. Further, tax noncompliance creates inefficiencies and distortions by pushing economic activity toward those areas where there are the most opportunities for evasion.

The President's proposals would address these deficiencies, benefitting those who fulfill their tax obligations, and raising revenue to fund urgent fiscal priorities. At the crux of these proposals is a commitment to revitalizing tax enforcement, decreasing noncompliance by about 10 percent over the course of a decade.

Achieving this goal will require providing the IRS the resources it needs for hiring specialized auditors, training them to detect noncompliance by sophisticated taxpayers, and investing in a 21st century technology infrastructure. Equally important, these investments are coupled with new third-party information reports that

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IRS required statutory authority to regulate in this space. The IRS's experience administering the test before this ruling indicates its importance: roughly 25 percent of unenrolled preparers who took it did not pass the exam. *See, e.g.,* GAO, 2014. "Protecting Taxpayers from Incompetent and Unethical Return Preparers: Hearing Before the Committee on Finance."

[62] National Taxpayer Advocate, 2018. "Most Serious Problem #7: Return Preparer Oversight: The IRS Lacks a Coordinated Approach to Its Oversight of Return Preparers and Does Not Analyze the Impact of Penalties Imposed on Preparers," Annual Report to Congress 2018.

[63] GAO, 2014. "In a Limited Study, Preparers Made Significant Errors: Statement of James R. McTigue, Jr., Director, Strategic Issues," GAO–14–467T.

[64] National Taxpayer Advocate, 2013. "Most Serious Problem #8: Return Preparer Fraud: The IRS Still Refuses to Issue refunds to Victims of Return Preparer Misconduct Despite Ample Guidance Allowing the Payment of Such Refunds," Annual Report to Congress 2013. IRS, 2021. "Beware of 'Ghost' Preparers Who Don't Sign Tax Returns," IR–2021–30.

the IRS can use to help detect evasion. More effective enforcement will improve the experience of most taxpayers by reducing the number of audits imposed on compliant taxpayers. A robust investment in the IRS will rebuild taxpayer service to help ensure that the agency is capable of responding to taxpayer needs in a timely manner and efficiently delivering tax credits, refunds, and other benefits to families and workers.

Overhauling tax administration in this manner will require a sustained, multi-year commitment to foundational change. Effective management of a well-resourced IRS will be essential to the agency's long-term success and will strengthen voluntary compliance in the United States. Frequent reporting on milestones and performance metrics—including a more current tax gap report—will be essential, providing insight into the efficacy of new programs.

Working to close the tax gap reflects a commitment to ending our two-tiered tax system, one where most American workers pay their full obligations, but high earners who accrue income from opaque sources often do not. The President's proposals address this inequity in a way that will pay large dividends in this decade—and in the decades to come.

PREPARED STATEMENT OF HON. MIKE CRAPO,
A U.S. SENATOR FROM IDAHO

Thank you, Mr. Chairman, and welcome again, Commissioner Werfel.

The IRS needs to be accountable for the choices it makes, become more efficient, rigorously plan, provide full transparency, and timely solicit real feedback from informed stakeholders—like Congress—before acting.

Despite claims that the $80 billion in new funding would "transform the IRS into a 21st-century agency," the President's budget request indicates otherwise. While modest progress has been made, there are other areas where the agency continues to miss the mark.

For example, last year, I raised concerns with the IRS's strategic operating plan, including its vagueness and missing line-item cost projections.

A year later, we are still missing important details, yet this year's budget asks for even more unprecedented IRS funding—more than $104 billion. This underscores that the initial windfall was not a cure, the IRS has not transformed, and the President believes the only way to realize that vision is to just spend more.

While I support a transformed IRS, this approach is not a solution. For $80 billion, one would expect transformational customer service changes and fully modern front- and back-end IT. Instead, it seems taxpayers have paid for mail to actually be opened and a decline in phone wait times. Meanwhile, several million items of taxpayer correspondence remain unanswered and half a million ID theft cases remain unresolved, on average, years later.

IT modernization funding is also scheduled to run out years before the IRS finishes updating its systems. I assume this is due, in part, to the bulk of the IRA funding being directed to enforcement.

An emblematic example of the "just spend more, no questions asked" approach is the Direct File program. Despite there already being multiple free filing programs offered by the IRS, the agency embarked on a redundant government-run tax preparation project, complete with all the attendant inefficiencies and conflicts of interest.

Just last week, a Government Accountability Office (GAO) report highlighted many ways the supposed pilot program has not followed best practices, including key planning, budgeting, and accountability failures. The report noted that while GAO could not determine how much the program has and will cost to develop and operate—the IRS having not provided sufficient information to do this—the current tab far exceeds $100 million just through FY 2024, all for an "option" that might only serve 100,000 taxpayers this year.

In contrast, the Federal Government spends less than $5 million a year to have 2 to 3 million taxpayers served in one of its free income tax preparation programs. Were the IRS to use this year's Direct File spending to pay third-party providers to prepare and file returns instead, literally hundreds of times the number of taxpayers could file for free.

The IRS spending hundreds of millions of its finite funding to simply "test" the utility of doing something that can already be done more efficiently, with better outcomes, and without very real conflicts, while simultaneously pleading for more funding, calls for more oversight.

Direct File is not my only concern with the IRS's current path. Other serious concerns include: continued IRS use of biased data and post-facto metrics to plan and justify its actions; indiscriminate IRS enforcement campaigns that pressure honest taxpayers and waste government resources; and the IRS's continued—and highly disproportionate—focus on increasing enforcement over improving taxpayer services.

Commissioner Werfel, while I appreciate a handful of positive steps the IRS has taken during your tenure, so much remains undone at the IRS that any victory lap is unwarranted.

I look forward to your testimony, Commissioner Werfel. Thank you, Mr. Chairman.

PREPARED STATEMENT OF HON. DANIEL I. WERFEL,
COMMISSIONER, INTERNAL REVENUE SERVICE

INTRODUCTION

Chairman Wyden, Ranking Member Crapo, and members of the committee, thank you for the opportunity to discuss the 2024 filing season and the IRS budget.

After a year as IRS Commissioner, it remains an honor for me to lead this great institution. My respect for the agency's role and admiration for its workforce continue to grow. I'm pleased to report the 2024 tax season opened on schedule on January 29th, and we've seen a historic filing season unfolding since then. Through March 30th, the IRS received more than 90.3 million individual income tax returns and issued more than 60.8 million refunds for more than $185.6 billion.

Going into the final days of tax season, the Inflation Reduction Act (IRA) funding has enabled the IRS to have one of its best filing seasons ever in terms of customer service. Wait times and level of service on our main phone lines have improved. We've dramatically expanded service in our walk-in sites, increasing hours and serving more taxpayers. And new and expanded tools on *irs.gov* are seeing heavy use. I will have more detail on these later in this testimony.

IRA funding has also enabled us to begin making critical inroads in addressing the tax gap and tax evasion among the most complex and largest filers, which represents a sharp turnaround from the past decade when our work was hindered by lack of resources. Our compliance work includes focusing on delinquency and nonfiling among high-income individuals, as well as leveraging artificial intelligence (AI) and hiring subject matter experts to find tax evasion among our largest and most complex partnerships and corporations.

But while we have seen a historically strong tax season so far, I want to be clear the IRS has much more work to do on many fronts: closing remaining gaps on phone service; expanding digital options for all taxpayers; further strengthening data security; and increasing support for vulnerable populations by such actions as increasing access to the Earned Income Tax Credit (EITC) and other refundable credits as well as protecting and supporting scam victims.

Our ongoing success hinges on sustained investments to make sure that we have the right size workforce, with the right training and tools as well as a modern technology infrastructure, with increasingly modern web-enabled tools for taxpayers. These are needed to ensure the IRS is ready to implement the tax system of today and the future.

Along with delivering the filing season and other day-to-day activities, we have a tremendous amount of transformation work taking place at the IRS. These changes, which are made possible by IRA funding, touch every part of our operations, from taxpayer service to tax enforcement to information technology and data security.

We have a unique opportunity—a once-in-a-generation chance—to envision and realize a future of tax administration that meets the evolving needs of taxpayers and the nation. Using IRA funding, there are three central themes I've been reminding taxpayers about this filing season:

- Ensuring taxpayers can easily contact the IRS—whether in person, on the phone or online—and get help navigating complex tax laws and accessing the credits for which they are eligible;
- Identifying the growing number of taxpayers with complex returns—including certain wealthy individuals, large corporations and complex partnerships—who are shielding income to evade their tax responsibility and collecting from them what is owed; and
- Addressing the growing risk of tax scams and schemes by protecting honest taxpayers from them and rooting out the nefarious actors that perpetrate them.

The IRS has many other goals and objectives supporting this effort as part of our strategic operating plan. This includes making dramatic improvements to our information technology (IT) infrastructure and design as well as delivering modern technology platforms that center around data and applications. These efforts will support all our transformation work.

Achieving this ambitious transformation agenda requires us to rebuild areas in the IRS that have suffered from more than a decade of underfunding that preceded the IRA. A critical change we are making involves providing our IRS workforce with the right tools—including training, technology and smarter processes—so we are ready now, and in the future, to meet our core mission of supporting taxpayers and the Nation.

Aiding us in our efforts, the President's Fiscal Year (FY) 2025 budget proposal would restore and maintain the full IRA investment in the IRS through 2034, avoiding funding cliffs that would dramatically degrade our ability in many different areas, including taxpayer services beginning in 2026. Sustained funding is necessary for us to build on the successes of the 2024 filing season and continue our work to:

- Make further phone service improvements, answering calls and other inquiries from taxpayers,
- Provide additional digital tools for taxpayers so the IRS can keep pace with the rest of the digital economy,
- Continue efforts to hold complex filers accountable for tax evasion,
- Make critical upgrades to our data security environment so that we remain one step ahead of evolving cyberattacks and other threats,
- Disrupt tax scams by bad actors and provide assistance to taxpayers victimized by such scams, and
- Deploy and sustain new technologies made necessary by an expanding tax system.

For these improvements to continue and accelerate, a consistent, reliable funding stream remains critical for the agency—both in regard to our annual appropriations and maintaining the IRA funding.

The decision about whether to adequately fund the agency comes down to a fundamental choice: Whether or not we will have an IRS that . . .

- Taxpayers can easily interact with to meet their tax responsibilities or resolve issues if they arise,
- Ensures fairness in the tax system through its enforcement activities,
- Quickly and effectively addresses tax scams that exploit vulnerable populations, and
- Has updated IT infrastructure and modern technology platforms capable of supporting our transformation work.

For the IRS to be able to do all these things, adequate stable funding is essential.

UPDATE ON THE FILING SEASON AND TRANSFORMATION EFFORTS

The IRS remains focused on improving service to taxpayers, offering them more in-person and online resources as part of our effort to deliver another successful tax season this year. Taxpayers and tax professionals saw additional improvements in our operations and service this year that made it easier for them to prepare and file taxes.

The IRS has worked hard to ensure this filing season would build on the accomplishments of last year. Early results show that we've exceeded several transformation goals set for the 2024 filing season:

- Again committing to an 85-percent level of service (LOS) on our main toll-free phone line during the filing season. As of early April, we have exceeded that

level of service, which means the vast majority of callers routed to live assistors have been able to connect and receive support.
- Committing to an average call wait time of 5 minutes or less on the agency's main taxpayer helpline. As of early April, we exceeded our goal, with our main line phones being answered in about 3 minutes.
- Giving taxpayers the ability to opt for a call back from the IRS if their wait time on the phone is more than 15 minutes. This has saved taxpayers many thousands of hours of wait times.
- Increasing self-service support in a number of areas, such as the Where's My Refund? and Where's My Amended Return? tools, which used conversational voice bot technology for the first time to help taxpayers get answers on the status of their refund or amended return more quickly.
- Providing more in-person help at our Taxpayer Assistance Centers (TAC), with a goal of delivering 8,500 more hours of in-person assistance than we did during the 2023 filing season. We have exceeded that goal, having delivered 9,000 more hours of in-person assistance. We expanded hours at nearly 250 TACs around the country during the filing season. And we again offered special Saturday hours at TAC locations around the country; this past Saturday, April 13th, we had more than 70 TACs open to help taxpayers.

Although these were ambitious goals, our workforce proved it is up to the challenge. The progress we have made thus far using IRA funding shows what is possible in the years ahead.

I'll have more to say about our efforts to provide world-class service, but first I'll turn to enforcement, where we've seen early success in ensuring the wealthiest Americans with ongoing issues pay what they owe.

On the compliance side we continue to take swift and aggressive action to ensure that high-income taxpayers who evade taxes play by the same rules as everyone else. We are increasing scrutiny of these taxpayers as we work to reverse the historically low audit rates for large corporations, complex partnerships, and high-wealth individuals that existed since before the IRA was passed.

As an example, we have concentrated our revenue officers' work on those taxpayers with more than $1 million in income and more than $250,000 in recognized tax debt. Over the past year, the total we have recovered through these new initiatives is about $500 million. **That's half a billion dollars recovered from fewer than 1,000 millionaires and billionaires.** That is just the beginning: Our revenue officers continue to work on hundreds of these cases to recover more back taxes from delinquent high-wealth individuals.

In a related effort, we recently launched an initiative focused on high-income taxpayers who have failed to file Federal income tax returns, some as far back as 2017. In February we began sending out compliance letters on more than 125,000 cases where tax returns haven't been filed. This includes more than 25,000 mailings to those with more than $1 million in income, and over 100,000 mailings to people with incomes between $400,000 and $1 million, between tax years 2017 and 2021. People who fail to respond to these letters will be subject to additional notices and other enforcement actions.

We are also closely examining potential noncompliance among the largest U.S. corporations and partnerships that were identified as higher risk for tax noncompliance with the help of new AI tools. As of December, the IRS had open audits of more than 75 of the largest U.S. partnerships. On average, they each have more than **$10 billion** in assets and represent a cross-section of industries that include hedge funds, real estate investment partnerships, publicly traded partnerships, large law firms, and other industries. IRA funding is also helping us expand our Large Corporate Compliance Program, which covers entities with average assets of more than **$24 billion** and average taxable income of about $526 million per year, and our hiring of new staff has allowed us to open 60 new audits of taxpayers in this group.

Another illustration of how our long-term funding is helping us more fully address high-risk compliance areas: We recently announced we are beginning dozens of new audits on corporate aircraft involving personal use. We are focusing on aircraft usage by large corporations, large partnerships and high-income taxpayers. The IRS has concerns that the use of these jets is not being properly allocated between business and personal activities. We are concerned people are using business aircraft for personal use, which means the businesses are taking deductions they may not be fully entitled to.

Personal use of corporate jets and other aircraft by executives and others has personal and business tax implications. This is a complex area where, in the past, IRS work has been stretched thin. With expanded resources, these aircraft audits will help ensure high-income groups aren't flying under the radar with their tax responsibilities.

In all its compliance work, the IRS's focus is on those posing the greatest risk to our Nation's tax system in terms of ensuring fairness. As I have previously stated, we remain committed to following the Secretary of the Treasury's directive not to increase audit rates relative to historical levels for small businesses and households earning less than $400,000 per year. All of this work will be with an eye toward fairness and always respecting taxpayer rights. Although focusing on these types of complex issues will be resource intensive, achieving our goals will result not only in a fairer tax system, but also in benefits for taxpayers and the Nation, because detecting and stopping noncompliance in these areas will result in significant additional revenues and reduce the deficit.

Launching the Direct File Pilot

As part of our effort to deliver significantly improved taxpayer services, the IRS has been conducting a limited-scope pilot this filing season of a system that allows taxpayers to prepare and file a tax return for free, online, directly with the IRS, called Direct File. Our work on Direct File is an important innovation in our ongoing efforts to transform the IRS and lead the agency into a digital, taxpayer-focused future.

This year, eligible taxpayers in 12 participating States had the option to prepare and file their return this way. The pilot will allow us to assess customer and technology needs, so we can evaluate and develop solutions and make a recommendation about the future of a Direct File system. After a successful testing phase, we announced on March 12th that all eligible taxpayers in the 12 States—representing 19 million taxpayers—could use the system at any time.

Thousands of taxpayers already have successfully used the system, and users are giving the new option positive reviews. These early results from Direct File have shown taxpayers like the ease and convenience of the tool.

It is important to note that a core part of the IRS's mission is to meet taxpayers where they are and ensure they have options to fulfill their tax obligations that meet their needs. I want to emphasize that taxpayers will always have choices for how they prepare their taxes. They can file using a trusted tax professional, our Free File program, tax software, or free tax preparation services such as the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs, or they can file a paper return. We saw an extremely successful filing season involving all of those options. We continue to emphasize that taxpayers should use the filing option that works best for them and their personal financial situation. Direct File is designed to be an additional option for some taxpayers this year that is simple, secure, accurate and free.

Progress on Transformation

IRA resources have been fundamental in our efforts to modernize our operations. The IRS is using this funding to upgrade our IT infrastructure and improve the experience for those who choose to interact with us online. By utilizing technology, we are making the IRS more efficient while meeting taxpayers where they are.

Along those lines, we continue to enhance our online offerings. We have expanded the capabilities of the IRS Online Account and Tax Pro Account, so this filing season taxpayers and tax professionals have been able to perform more types of transactions in their accounts. We also launched a Business Tax Account to make interacting with us easier for small business owners.

We have also made critical progress on our Paperless Processing Initiative. While online options for taxpayers have increased, the IRS has continued to be flooded with paper, including tax returns and correspondence. We had been working toward digital scanning of paper forms and returns for some time, but the IRA funding has allowed us to greatly accelerate these efforts. For example, during Calendar Year 2023, we scanned more than 1.5 million forms and returns we received on paper.

Additionally, we are making progress toward our 5-year goal of giving taxpayers the ability to securely file all documents and respond to all notices online, as well as securely access and download their data and account history. We met our first goal of this initiative 3 months ahead of schedule. Taxpayers are now able to digitally submit all correspondence and responses to notices.

Complementing these efforts, the IRS recently announced a sweeping initiative to simplify and clarify about 170 million letters sent annually to taxpayers. The Simple Notice Initiative builds on notice-redesign efforts already in place for the 2024 tax season and expands on a recent successful pilot involving identity theft letters. The redesign work will accelerate during the 2025 and 2026 filing seasons, improving common IRS letters going out to individual taxpayers and then expanding into notices going to businesses.

The IRS also made significant progress in bringing our paper inventory back to manageable levels after COVID-related interruptions in our operations resulted in historic backlogs. Inventory challenges involving original returns have been completely resolved.

Taken together, these initiatives will make it easier for taxpayers to respond to notices from the IRS. They have the option to go paperless and conveniently submit necessary responses online, and they will receive clearer and more concise IRS notices, so they can better understand the actions they need to take.

ENHANCING DATA SECURITY

The IRS works continuously to preserve taxpayer privacy and protect our computer systems from cybersecurity incidents through a combination of preventative and detective controls. IRS systems withstand well over 1 billion cyberattacks annually (including denial-of-service attacks; unsuccessful intrusion attempts, probes, or scans; and other unauthorized connectivity attempts). Since I became Commissioner, I have seen teams across the IRS make amazing progress to improve our security posture, permanently closing gaps utilizing IRA funding to make needed updates, and we continuously work to ensure that taxpayers and our own systems are protected.

We continue to strengthen our systems, training and overall infrastructure under the strategic operating plan, funded by the IRA. Measures we have taken include (but are not limited to):

- **Further restricting user access.** We restructured our operations to reduce the number of people with access to the most sensitive taxpayer datasets.
- **More robust protective security controls.** We updated data protection mechanisms—including encryption and anonymization—to better protect taxpayer information.
- **Improved firewalls.** We have added additional firewalls between key taxpayer information and the rest of the IRS, providing additional monitoring capabilities.
- **Stronger 24/7 monitoring.** We have expanded advanced analytics to detect and prevent risky data usage, providing improved insight into suspicious activities around the clock.
- **New tools.** We are adding new analytical tools and dashboards to monitor user activity involving sensitive data. These tools will help to improve the detection of potential data misuse.

The bottom line is that as Commissioner I have made it a priority to improve the data security protections at the IRS against potential internal and external threats. Taxpayer data must always be protected and safeguarded, and any unauthorized disclosure will not be tolerated. We've made remarkable progress and have dramatically reduced risk in all aspects of data security, and we will remain focused on this in the future.

COMBATING FRAUD: EMPLOYEE RETENTION CREDIT

The IRS is committed to protecting hardworking people and small businesses from scammers and fraudsters who try to use the tax system for their schemes. Along those lines, we continue to face a major challenge related to scams involving the Employee Retention Credit (ERC).

The ERC provided a financial lifeline to millions of businesses and exempt organizations during the pandemic. The IRS has worked hard to implement this credit, and we have processed about 3.6 million ERC claims worth approximately $230 billion to businesses. However, promoters have been aggressively misleading people and businesses that are not eligible into claiming the ERC, even though they do not qualify.

The IRS has been flooded with ERC claims, and we are concerned that many of these claims were not being filed by businesses that qualify. We appreciate the patience of businesses and tax professionals as we continue our effort to protect

against fraud. Since last fall we have been intensifying our compliance work in this area.

Last September, as we were being inundated by questionable ERC claims, we announced a moratorium on processing new claims to allow us time to make adjustments and add taxpayer protection provisions into the program, including options for businesses that may have been unduly pressed by a promoter.

Since then, the IRS has taken a number of actions, which together have protected more than $1 billion between September 2023 and mid-March 2024:

- We continue to offer a withdrawal option for businesses with a pending ERC claim, which allows certain employers that filed a claim—but have not yet received a refund—the ability to withdraw their submission and avoid future repayment, interest, and civil penalties on a refund for which they are ineligible. Claims that are withdrawn are treated as if they were never filed. A total of 1,800 entities have withdrawn a total of $251 million in claims so far.
- In December, we sent letters to more than 20,000 businesses notifying them of disallowed ERC claims. Since then, we have determined that more than 12,000 entities filed more than 22,000 claims that were improper and resulted in $572 million in assessments that the IRS will be working to recoup. The IRS is continuing this work with all of our available compliance tools, and more activity is planned in this area in the months ahead.
- Also in December, we launched a special ERC Voluntary Disclosure Program that ended on March 22nd. The program allowed voluntary repayments by businesses that received an improper ERC payment. Those accepted into the program needed to repay only 80 percent of the credit they received. This has yielded more than $225 million from over 500 taxpayers, with another 800 submissions still being processed, including many that came in at the last minute before the March 22nd deadline.

During this period, we have processed some ERC claims, but at a much slower rate than before our approach changed in the summer and fall. While we continue to process ERC applications received prior to the moratorium, our progress is hampered by the fact that amended returns from ERC applicants come in on paper and require time-intensive manual processing. We are developing a scanning process for both pre- and post-moratorium paper returns so that we can digitize the information from other pending claims and expect that process to be completed this spring. We continue our work to determine next steps involving ERC.

This current situation is an excellent example of where IRA funding will make a difference in the future. These claims are being filed on paper. The IRA funding will give us improved capability to receive digital information, whether on amended returns or other information such as taxpayer correspondence. In turn, this will help us more rapidly identify risks and develop response strategies—the exact issue that we have confronted with the ERC claims.

Additionally, the IRS remains very serious about tracking down unscrupulous promoters of the ERC. We have specially trained auditors examining ERC claims that pose the greatest risk. Also, our Criminal Investigation Division is conducting hundreds of investigations involving potentially false claims worth billions of dollars.

THE PRESIDENT'S FISCAL YEAR (FY) 2025 BUDGET

The President's FY 2025 budget proposal for the IRS provides $12.3 billion in discretionary appropriations, equal to the FY 2024 and FY 2023 enacted levels. As the IRS implements its plans for transformative change with the significant resources provided by the IRA, annual discretionary appropriations need to provide sufficient recurring "base" resources.

However, with no anticipated discretionary increases for inflationary requirements in FY 2024 and FY 2025, the IRS will be required to further extend its reliance on IRA resources to fund base needs. IRA resources are limited, and the IRS will likely use them entirely before the funding expires in FY 2031. In addition, the authorizing language does not provide the flexibility to realign the IRA funds across appropriations.

This will have the most immediate impact on the taxpayer services appropriation, with IRA resources for this category expected to run out completely by FY 2026. The IRS is spending much more on taxpayer services than is provided for in annual appropriations, with IRA funding heavily supplementing telephone and in-person service. Without additional funding or additional flexibility to realign between appro-

priations, IRS telephone LOS is expected to see a drastic decline in FY 2026 and fall even further in FY 2027. In this scenario, the vast majority of taxpayers would be unable to reach an IRS representative for assistance and millions of pieces of taxpayer correspondence would not be answered in a timely manner.

To address this issue, the President's budget includes a mandatory proposal that will avert the IRA funding "cliffs" (after which IRA funds are exhausted for a given appropriation) and will extend IRA funding through FY 2034. This proposal would provide $104 billion over the 10-year budget window and is estimated to generate at least an additional $341 billion in revenue. It will ensure the IRS can continue its transformation efforts—as described in our strategic operating plan—to improve service, modernize technology and ensure that taxpayers with complex returns, including certain high-income individuals, large corporations and complex partnerships, pay the taxes they owe.

We have worked to identify the highest priority areas of focus through filing season 2025, with a second sprint to cover efforts through filing season 2026. The following represent the areas of focus from this work:

- *Digitalization.* Digitizing all paper documents we receive from taxpayers and enabling our employees to perform their work digitally.
- *Fairness in enforcement.* Expanding enforcement efforts for complex taxpayer segments while simultaneously ensuring fairness for taxpayers at all income levels. This includes providing the outreach and support necessary to ensure taxpayers receive the benefits for which they are eligible.
- *Live assistance.* Ensuring that when taxpayers need answers from the IRS, we are available.
- *Notifications and scams.* Providing taxpayers with clear and concise notices, and stepping in to disrupt and dismantle scams while providing support to victims.
- *Self-service and online accounts.* Giving taxpayers the option to address all of their tax-related needs with the IRS online if they choose.
- *Employee tools and experience.* Enabling a fully equipped, empowered and engaged IRS workforce ready to serve taxpayers.
- *Foundational technology.* Modernizing the IRS's foundational technology to meet the needs of taxpayers and IRS employees.
- *Human capital.* Attracting, retaining and empowering a highly skilled, diverse workforce that is better equipped to deliver results for taxpayers.

LEGISLATIVE PROPOSALS IN THE PRESIDENT'S FY 2025 BUDGET

Along with the funding requested in the President's FY 2025 budget request, we are also requesting legislative proposals that would improve tax administration, including, but not limited to, the following:

- ***Direct Hire Authority and Streamlined Critical Pay.*** The President's budget includes two administrative provisions within the appropriations language designed to expand Direct Hire Authority (DHA) and provide the ability to offer Streamlined Critical Pay (SCP) to certain new hires to accelerate IRS hiring efforts. DHA provides the ability to expedite the normal hiring process to hire more efficiently during a severe shortage of highly qualified candidates or during a critical hiring need. DHA has helped the IRS address the backlog of paper tax returns and taxpayer correspondence. As the IRS works to rapidly implement plans to utilize IRA resources, expanded DHA will help ensure that hiring delays are not an obstacle for achieving broad mission related functions. The current DHA provision will expire in 2024; the proposal included in the budget will extend DHA through 2027. SCP authority gives the IRS a management tool to quickly recruit and retain a limited number of employees with high levels of expertise in technical or professional fields that are crucial to the success of the IRS's transformative efforts by allowing for higher base salaries for these hires than would otherwise be possible. The current SCP authority will expire in 2025; this proposal would extend it through September 30, 2031.
- ***Provide for information reporting by certain financial institutions and digital asset brokers for purposes of exchange of information.*** Over time, the United States has established a broad network of information exchange relationships with other jurisdictions based on established international standards. The information obtained through those relationships has been central to recent successful IRS enforcement efforts against offshore tax evasion. The ability to exchange information reciprocally is particularly important in connection with the implementation of the Foreign Account Tax Compliance Act (FATCA).

Currently, however, the United States provides less information to foreign governments than we receive from them. The proposal would expand reporting by U.S. financial institutions and digital asset brokers with respect to foreign account holders in a number of ways—for example, by requiring financial institutions to report the account balance for all financial accounts maintained at a U.S. office and held by foreign persons. These new reporting requirements would enable the IRS to provide equivalent levels of information to cooperative foreign governments in appropriate circumstances to support their efforts to address tax evasion by their residents. The proposal would be effective for returns required to be filed after December 31, 2026.

- ***Require reporting by certain taxpayers on foreign digital asset accounts.*** Section 6038D(b) of the Internal Revenue Code contains an annual reporting requirement for individuals in regard to two categories of foreign financial assets, but there is no reporting requirement under this section for digital assets. Against this backdrop, tax compliance and enforcement with respect to digital assets is a rapidly growing problem. The global nature of the digital assets market offers opportunities for U.S. taxpayers to conceal assets and taxable income by using offshore digital asset exchanges and wallet providers. The proposal would amend section 6038D(b) to require reporting with respect to a new third category of asset: that is, any account that holds digital assets maintained by a foreign digital asset exchange or other foreign digital asset service provider. Reporting would be required *only* for taxpayers who hold an aggregate value of all three categories of assets in excess of $50,000. The proposal would be effective for returns required to be filed after December 31, 2024.
- ***Extend the statute of limitations for certain tax assessments.*** Section 6501 of the Internal Revenue Code generally requires the IRS to assess a tax within 3 years after the filing of a return. But for complex audits in the largest cases, critical issues may not be identified until late in the process of an examination, and in many cases these issues cannot be pursued further due to time and resource constraints. The proposal would amend section 6501 to extend the 3-year statute of limitations to 6 years if a taxpayer omits from gross income more than $100 million on a return. This change would give the IRS enhanced agility and flexibility in evaluating and staffing its case inventory and appropriately allocating its limited enforcement resources. The proposal would be effective for returns required to be filed after the date of enactment.
- ***Increase oversight of paid tax return preparers.*** Paid tax return preparers have an important role in tax administration because they assist taxpayers in complying with their obligations under the tax laws. The proposal would amend title 31, U.S. Code (Money and Finance) to provide the Secretary with explicit authority to regulate all paid preparers of Federal tax returns, including by establishing mandatory minimum competency standards. The proposal would be effective on the date of enactment.
- ***Expand and increase penalties for noncompliant return preparation and e-filing.*** Inappropriate behavior by paid tax return preparers harms taxpayers through the filing of inaccurate returns, erroneous refunds and credits, and personal tax return noncompliance. Tax return preparer misconduct continues, in part, because the amounts of the penalties under current law do not adequately promote voluntary compliance. The proposal would increase the amount of the tax penalties that apply to paid tax return preparers for willful, reckless, or unreasonable understatements, as well as for forms of noncompliance that do not involve an understatement of tax. The proposal would be effective for returns filed after December 31, 2024.
- ***Expand authority to require electronic filing for forms and returns.*** Under this proposal, electronic filing would be required for returns filed by taxpayers reporting larger amounts or that are complex business entities, including: (1) income tax returns of individuals with gross income of $400,000 or more; (2) income, estate, or gift tax returns of all related individuals, estates, and trusts with assets or gross income of $400,000 or more in any of the 3 preceding years; (3) partnership returns for partnerships with assets or any item of income of more than $10 million in any of the 3 preceding years; (4) partnership returns for partnerships with more than 10 partners; (5) returns of real estate investment trusts, real estate mortgage investment conduits, regulated investment companies, and all insurance companies; and (6) corporate returns for corporations with $10 million or more in assets or more than 10 shareholders. Further, electronic filing would be required for the following forms: (1)

Form 8918, Material Advisor Disclosure Statement; (2) Form 8886, Reportable Transaction Disclosure Statement; (3) Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons; (4) Form 8038–CP, Return for Credit Payments to Issuers of Qualified Bonds; and (5) Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business. Return preparers that expect to prepare more than 10 corporation income tax returns or partnership returns would be required to file such returns electronically. The Secretary would also be authorized to determine which additional returns, statements, and other documents must be filed in electronic form in order to ensure the efficient administration of the internal revenue laws without regard to the number of returns that a person files during a year. The proposal would be effective for forms and returns required to be filed after December 31, 2024.

- ***Improve reporting for payments subject to backup withholding.*** Backup withholding applies to a reportable payment if a payee fails to furnish the payee's taxpayer identification number (TIN) to the payor in the manner required. It is an enforcement tool that ensures payors and payees are compliant with reporting obligations. Currently, the IRS may only require that the payee furnish the TIN under penalties of perjury with respect to interest, dividends, patronage dividends, and amounts subject to broker reporting. Payees of these reportable payments are generally required to furnish their TINs using a Form W–9, Request for Taxpayer Identification Number and Certification. However, payees of other reportable payments subject to backup withholding may furnish their TINs in other ways. The proposal would treat all information returns subject to backup withholding similarly. Specifically, the IRS would be permitted to require payees of any reportable payments to furnish their TINs to payors under penalty of perjury. The proposal would be effective for payments made after December 31, 2024.
- ***Improve IRS data disclosure to Tribal child support services and to child support services contractors.*** Section 6103 of the Internal Revenue Code prohibits the disclosure of return information except under specific circumstances. For example, section 6103 authorizes the IRS to disclose certain return information to Federal, State, and local child support enforcement agencies (CSEs). The section further authorizes CSEs to disclose some, but not all, of that information to their contractors. There is no explicit authority for the IRS to disclose to Tribal CSEs or their contractors return information for purposes of child support enforcement. The proposal would expand the IRS's authority to allow CSEs to share information with their contractors. It would also provide Tribal CSEs with the same access to the same return information as Federal, State, and local CSEs. These changes would facilitate the establishment and collection of child support obligations, locating individuals owing child support, and the administration of the Federal tax refund offset program. These proposals would be effective upon enactment.

CONCLUSION

Chairman Wyden, Ranking Member Crapo, and members of the committee, thank you again for the opportunity to update you on the filing season and the IRS budget. The 2024 filing season has been a good one overall, and, assuming the agency receives adequate funding going forward, the future holds great promise for the agency and the taxpayers we serve. As Commissioner, I remain committed to leading the IRS's transformation efforts in close collaboration with your committee, and I look forward to working with you to achieve a more modern and high-performing IRS, which will better serve taxpayers and our Nation.

QUESTIONS SUBMITTED FOR THE RECORD TO HON. DANIEL I. WERFEL

QUESTION SUBMITTED BY HON. RON WYDEN

Question. Whistleblowers play an essential role in helping to identify and root out tax cheating schemes that rip off the American people. The numbers show that the IRS whistleblower program works, and my view is the IRS ought to look for every opportunity to improve it. That's why I was glad to hear you say at the hearing that you would investigate ways of expediting payments to whistleblowers.

My understanding is that the IRS can make partial payments of whistleblower awards, but the Internal Revenue Manual limits such payments to situations where

the partial payment is determined to be in the "best interest" of the IRS and even then, only to the extent "necessary to efficiently administer the program."

How will you ensure that whistleblowers start to get paid more quickly?

Answer. The Whistleblower Office seeks to make award payments as soon as they are permitted under the law. Awards cannot be paid until the relevant taxpayer audit or investigation is completed and proceeds are collected with finality. The Whistleblower Office's ability to make an award payment is heavily dependent on the IRS's separate enforcement actions against the taxpayer, including the audit or investigation of the taxpayer, the taxpayer's exercise of rights to request assistance from the Independent Office of Appeals or to litigate disagreements, and the time it takes to collect any proceeds from the taxpayer with finality. Similarly, a whistleblower's appeal of their award determination will delay payment until the litigation is final. These variables, which are outside of the Whistleblower Office's control account for most of the time between submission of an award claim and an award payment.

The whistleblower statute provides for awards on proceeds collected as a result of an action. The proceeds collected must have finality, which generally precludes partial or ongoing payments. Consistent with the statute, the regulations, provide discretion to the Whistleblower Office to aggregate or disaggregate actions for purposes of determining awards. This permits the Whistleblower Office to make separate award determinations on different actions identified within the same whistleblower claim.

The Whistleblower Office has sought to disaggregate eligible claim submissions to allow for earlier payments when an award claim involves multiple actions. For example, if the IRS pursues multiple taxpayers in response to a whistleblower's claim, the Whistleblower Office may issue a separate final determination with respect to each taxpayer, if there is a difference in timing on the collected proceeds. Disaggregating award claims has been a recent point of emphasis for the Whistleblower Office. In Fiscal Year (FY) 2024, nearly 90 percent of awards paid were for disaggregated award determinations.

While the average cycle time for paying an award under section 7623 [1] is currently over 10 years, this isn't due to an IRS policy prohibiting partial payments. As noted above, nearly 90 percent of the awards paid in FY 2024 were disaggregated award payments where the Whistleblower Office disaggregated claims meeting the regulatory requirements for issuing an award payment from those that still had ongoing administrative and judicial actions, and/or active collection/refund statutes, and made a final determination with respect to those disaggregated claims. In FY 2024, on average, the IRS issued section 7623(b) award payments within 48 days of all regulatory requirements being met.

The IRS is currently developing and implementing a plan to improve the whistleblower program. One of the initiatives identified in that plan is to clarify guidelines when additional levels of disaggregation would be appropriate. The Whistleblower Office updated the IRM to clarify the types of disaggregation and factors to be considered for potential on September 13, 2024. Another initiative in the plan is to increase the capacity for processing whistleblower claims. As part of this initiative the Whistleblower Office is hiring additional analysts for processing whistleblower claims and award determinations as well as additional staff members focused on data and analytics to ensure determinations are made timely.

QUESTIONS SUBMITTED BY HON. MIKE CRAPO

Question. To reiterate a live question, please provide a report detailing the concrete steps the IRS will hereafter take to quickly and thoroughly resolve unresolved ID theft cases, as well as an analysis of reasons why there are so many cases in the first place.

Answer. The IRS takes identity theft (IDT) seriously and is committed to returning to our pre-pandemic standard of resolving these cases within 120 days or less. Fraudsters have targeted pandemic-era legislative measures and relief to commit IDT. This led to a surge in Identity Theft Victim Assistance (IDTVA) cases, dras-

[1] All section references are to the Internal Revenue Code of 1986, as amended, unless otherwise noted.

tically increasing IDTVA's inventories at time when IRS resources were stretched and causing an increase in the average amount of time to resolve IDT cases.

Through June 1, 2024, the total number of cases in our IDTVA inventory is approximately 594,000. This includes both tax-related IDT inventory of approximately 513,000 cases and non-tax-related IDTVA inventory which includes 81,000 cases. The average time to resolve IDTVA cases for fiscal year 2024 through April is 638 days.

ACTION PLAN TO REDUCE CYCLE TIME IN 2024

We have taken several steps to reduce the inventory and the number of days to resolve these cases, including:

- **Adding Customer Service Representatives (CSRs).** More IDTVA program employees have been trained on full scope IDT. Additional employees have also been trained on non-tax related IDTVA. The assignment of IDTVA CSRs to IDT paper inventory has been prioritized by limiting toll-free phone assignments when possible.
- **Overtime.** Funding has been allocated to the IDTVA program to increase the pace of case resolution.
- **Enhanced Review of IDTVA Cases.** We are reviewing IDT cases to determine which cases we can close systemically or move to another area within the IRS if they were referred to IDTVA in error.
- **Education.** We are providing additional guidance, in particular explaining when filing a Form 14039, Identity Theft Affidavit, is needed.
- **Processing Improvements.** We implemented the Form 14039 Digital Upload Tool to allow taxpayers to submit their Form 14039 directly to the IRS electronically. We are also working to identify process improvements.
- **Case Identification.** We are working to identify IDTVA cases that fit within identified criteria to pre-identify the fraudulent return for the IDTVA caseworker. This will reduce the amount of research needed and improve efficiencies.

In addition to the aforementioned items, we will continue to explore other options to reduce IDTVA inventory. At the same time, we're committed to protecting taxpayers by detecting, preventing, and deterring tax-related IDT.

Question. Please provide the following information with respect to the Direct File pilot program.

As of the end of each filing week in the 2024 tax filing season, please provide: the total number of Direct File returns submitted as of such date; the total number of Direct File returns accepted as of such date; and the rate that submitted returns were not accepted by the IRS.

For purposes of answering this question, the end of a filing season week can be any day of the week so long as that day is used consistently for all weeks and so long as the day of the week utilized is specified.

Answer. Over the course of the pilot, more than 3.3 million taxpayers started the Direct File Eligibility Checker, 423,450 taxpayers logged in to Direct File, and 140,803 taxpayers submitted accepted returns. More detailed information about the number of Direct File return and acceptance rates can be found in IRS Publication 5969, IRS Direct File Pilot Program: Filing Season 2024 After Action Report, May 3, 2024, available at *https://www.irs.gov/pub/irs-pdf/p5969.pdf*.

Question. As of April 15, 2024, please provide: the total number of Federal Government FTEs (employees and contractors) that are currently tasked with supporting Direct File; the total number of IRS FTEs (employees and contractors) that are currently tasked with supporting Direct File; the total number of IRS customer-service-related FTEs (employees and contractors) that are currently tasked with supporting Direct File; and a list of each occasion on or after May 16, 2023, where any of the following listed individuals publicly referenced the Direct File program, such as in a public statement, press release, media quote, interview, social media posting, et cetera.

The individuals are: the President, Vice President, other senior administration officials (*e.g.,* any Assistant or Deputy Assistant to the President, any senior advisor to the President, Chief of Staff or Deputy Chief of Staff, Press Secretary, Commu-

nication Advisor, head or deputy head of an executive office or Office of the President), any member of the Cabinet, the Deputy Secretary of the Treasury, any Assistant Secretary of the Treasury, the head or deputy head of any office of the Treasury, the IRS Commissioner, the IRS Deputy Commissioner, any Chief Officer of the IRS, any Division Commissioner of the IRS, any Director of an IRS office, and any member of the IRS Direct File team.

As of one week before the date of your response to these questions, please provide: the total number of taxpayers that began the process of filing a return using Direct File but who did not ever submit a return that the IRS accepted; the total number of returns that were submitted to the IRS via Direct File but which were not accepted by the IRS; the total number of returns that were begun on Direct File but which were never completed; the total number of Federal Government FTEs (employees and contractors) that were involved in the Direct File program at any point (*e.g.,* study-phase, pilot-phase, et cetera) but are not involved as of such date; a list of each contractor (by entity, or in the case of an individual providing services in a capacity unaffiliated with an entity, by individual) who provided services to the Federal Government with respect to the Direct File program; the total amount of resources the IRS has expended in furtherance of the Direct File program; the total amount of resources the IRS has budgeted to expend (measured as of the later of April 15, 2024 or one week before the date of your response) in furtherance of the Direct File program through FY 2030, broken out by fiscal year; and a description of the resources expended or budgeted to be expended.

Answer. In the report to Congress, the IRS estimated that the annual cost for Direct File could range from between $64.3 to $248.9 million for a service that reached between 5 to 25 million taxpayers depending on the tax scope and the taxpayers reached. We noted that these estimates were subject to uncertainty due to the nature of launching a new product like Direct File. The pilot provided an opportunity to collect concrete data on the cost of Direct File.

Through April 20, 2024, the IRS spent $24.6 million on Direct File, which includes $11.6 million in costs for the development of last year's report to Congress. Of the $13.0 million spent on pilot development and implementation, $10.6 million is technology and product development costs and $2.4 million is operational costs (customer service, cloud computing, user authentication, etc.). To build and run the pilot, the IRS also engaged the U.S. Digital Service (USDS). The IRS's agreement with the U.S. Digital Service did not involve costs to IRS, see response below. The limited design of the pilot means that the IRS was not able to benefit from economies of scale. If the number of Direct File users were to increase, the cost per return would decrease.

$ in Millions	FY 2023	FY 2024 YTD	Total through FY 2024 YTD
FY 2023 Direct File Feasibility Study and Report to Congress	**11.6**	–	**11.6**
Technology and Product	11.6	–	11.6
Labor	0.8	–	0.8
Non-Labor	10.8	–	10.8
Advisory and assistance service	*8.6*	–	*8.6*
Equipment	*0.3*	–	*0.3*
Other goods and services from Federal sources	*1.9*	–	*1.9*
Direct File Pilot Development and Implementation	**1.5**	**11.5**	**13.0**
Customer Service	0.1	1.8	1.9
Labor	0.1	1.8	1.9
Technology and Product	1.4	9.7	11.0
Labor	*0.2*	*2.9*	*3.1*
Non-Labor	1.2	6.8	8.0
Advisory and assistance services	*1.2*	*3.2*	*4.4*
Ongoing cloud services	–	*0.5*	*0.5*
Equipment	–	*0.2*	*0.2*

$ in Millions	FY 2023	FY 2024 YTD	Total through FY 2024 YTD
Other goods and services from Federal sources	–	*2.8*	*2.8*
Travel and transportation of persons	–	*0.1*	*0.1*
Grand Total	**13.1**	**11.5**	**24.6**

Note: FY 2024 labor includes actuals through April 6, 2024 and an accrual through April 20, 2024. Costs do not include other shared corporate costs.

These totals include costs associated with vendor support and an interagency agreement with General Services Administration's (GSA) 18F. To build and run the pilot, the IRS also engaged 29 employees from the U.S. Digital Service (USDS) to supplement the IRS employees and other team members. The USDS costs are not included in the $24.6 million spent on Direct File. The IRS estimates that the annualized cost for the USDS team is $7.2 million. While the costs outlined above all center on the actual costs involved in delivering the pilot, the team is using this data to develop a more robust cost estimate for potential future costs for delivering Direct File.

The Direct File pilot was the largest use of live chat support within the IRS to date. It allowed the agency to continue learning how live chat meets taxpayer preferences and expectations and how taxpayers would react when live chat was the only option for receiving assistance. This has the potential to impact IRS taxpayer service overall as the agency looks to provide taxpayers with more choices in how they can interact with the IRS.

From March 4, 2024, through April 20, 2024, Direct File staffing averaged 41 CSRs per day. This average was determined by using the total CSR hours available to chat in the system, divided by 7.5 hours of production time over a total of 47 workdays. The actual quantity of CSRs varied throughout the 15-hour workday (7:00 a.m. to 10:00 p.m. Eastern), from a low of 7 CSRs to a high of 62 CSRs. The CSRs handled 38,600 chats with an Average Handle Time of 9 minutes. Based on the staffing available to support the pilot, the IRS had the capacity to handle approximately 450,000 Direct File chats per month. Given that approximately 10 percent of pilot participants engaged customer support, this means the IRS could have assisted 4.5 million filers with the 400 CSRs who were trained for the pilot.

Question. With respect to GSA, 18F, SSA, and USDS, please provide: a description of their involvement with the Direct File program at any point in time; a timeline of their participation in the Direct File program; the total amount of resources each of these has expended in furtherance of the Direct File program; as of the later of April 15, 2024 or 2 weeks before the date of your response, the total amount of resources each of these has budgeted to expend in furtherance of the Direct File program through FY 2030, broken out by fiscal year; and a description of the resources expended or budgeted to be expended.

Answer. Both GSA (through 18F) and USDS supported the IRS in our work to deliver the Direct File and were essential to the successful delivery of the pilot. While the cost of USDS was born by the Office of Management and Budget (OMB), the IRS entered into an Interagency Agreement (IAA) with GSA to cover the cost of the 18F support. As noted in the IRS Direct File Pilot Program Filing Season 2024 After Action Report dated May 3, 2024, Publication 5969 (Direct File After Action Report),[2] the IRS estimates that the annualized cost for the USDS team is approximately $7.2 million. The IAA for the 18F team is approximately $5.5 million for April 2023 through May 2025. The costs of the 18F IAA were included in the estimates the IRS has provided on the cost to delivery Direct File. We have not entered into any longer-term agreements with either 18F or USDS.

Question. Please identify each reference to the U.S. Code and/or Code of Federal Regulations that the IRS believes establishes or otherwise supports a basis for claiming it is authorized to conduct the Direct File program, as well as a description of why such cited provision establishes or supports such claim.

Answer. The IRS has the authority to offer Direct File as a filing option.

[2] *See* IRS Direct File Pilot Program Filing Season 2024 After Action Report dated May 3, 2024, Publication 5969, *https://www.irs.gov/pub/irs-pdf/p5969.pdf.*

Direct File is an important part of our ongoing effort to meet taxpayers where they are and give them choices to interact with the IRS in the manner they prefer. The IRS has a long history of innovations to help taxpayers file their taxes as easily as possible, as mandated in the Taxpayer Bill of Rights. For example, in 1986, the IRS launched a pilot program to prove the technical feasibility of the Electronic Filing System (EFS). In its pilot year, EFS accepted 25,000 returns submitted electronically by five tax preparers in three cities. In 1987, 66 tax preparers in seven cities filed 78,000 returns electronically, while the IRS slowly expanded the program's tax scope and capabilities. When IRS e-File became operational nationwide in 1990, 4.2 million returns were filed electronically. Within the first 25 years after its limited pilot, IRS e-File surpassed 1 billion returns; every year since, e-File has processed more than 100 million returns electronically, and today 93 percent of tax returns are filed electronically.

In 2002, Treasury Secretary Paul O'Neill asked IRS Commissioner Charles Rossotti to establish a partnership with tax software companies to develop a free online filing system, managed by the IRS, for low-income taxpayers. The impetus behind Secretary O'Neill's request was to boost individual e-filing as part of the Treasury Department's implementation of President George W. Bush's 2001 E-Government Initiative. The IRS established the public-private partnership, the Free File Alliance, which has evolved into our current partner, Free File, Inc. (FFI). The IRS and FFI have extended and revised their original memorandum of understanding five times, most recently in May 2024, which extends the program through 2029.

Providing taxpayers with additional choices strengthens the tax filing system, and importantly, Direct File is one option among many from which taxpayers can choose.

Question. Please identify each reference to the U.S. Code and/or Code of Federal Regulations that the IRS believes establishes or otherwise supports a basis for claiming that with respect to the Direct File program none of its conduct results in the IRS being engaged in the preparation of tax returns or acting as a return preparer, as well as a description of why such cited provision establishes or supports such claim.

Answer. Direct File is an online tool provided by the IRS that allows taxpayers to file their returns for free, directly with the IRS. It uses an interview-based platform to help taxpayers self-prepare their own returns. Direct File guides taxpayers through the process of preparing a tax return by asking questions which the taxpayer can answer without needing to consult other instructions or IRS publications. Direct File uses these answers to fill out the forms and schedules of a tax return, which the taxpayer can review and choose to electronically file. But providing Direct File does not make the IRS a return preparer under the Internal Revenue Code (IRC).

Under the IRC, the definition of "tax return preparer" depends on the specific provision that is referenced. Generally, a tax return preparer is defined in section 7701(a)(36)(A) as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title."[3] Here, Direct File does not prepare returns for compensation or employ others to prepare returns for compensation. It is a free tool for taxpayers to prepare their own returns. Moreover, a person is not a tax return preparer if the person merely provides "typing, reproducing, or other mechanical assistance."[4] A computerized tax return preparation service is considered to be a tax return preparer under section 7701(a)(36) only if it provides substantive determinations, beyond mere typing, reproducing, and other mechanical assistance.[5] Finally, under Treas. Reg. § 301.7701–15(f)(1)(i), any official or employee of the IRS performing official duties is not a tax return preparer.

As noted previously, the IRS provides various tools, including Direct File, on its website and through other channels to help taxpayers prepare and file their own returns. Direct File is not a paid service and does not make substantive determinations as to the correctness of the reported amounts shown on the return.

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[3] *See* Treas. Reg. § 301.7701–15; *see also* Circular 230, § 10.2(a)(8).
[4] I.R.C. § 7701(a)(36)(B).
[5] *See* Rev. Proc. 85–187, 1985–2 C.B. 338.

Question. Will you return to speak with the Senate Finance Committee before making a determination over whether to continue and/or expand the Direct File program?

Answer. Once I decided to make Direct File permanent, I notified the chairman and ranking member of the Senate Finance Committee of my decision.

Question. The IRS budget projects that the proposed $104 billion in additional multiyear funding would generate approximately $341 billion through FY 2034.

Can you describe how the IRS came to the projection of $341 billion in revenue? Please be specific. For example, what group of taxpayers would generate the bulk of the $20.1 billion in estimated revenue in 2034, and what information is that estimate based on?

Answer. The proposal restores the full IRA investment in the IRS and extends it through 2034, and would provide funding for taxpayer services, business systems modernization, operations support, and enforcement. The estimated revenue considers the effect of the proposed increase in enforcement resources. The IRS intends to extend the IRA funded compliance work on taxpayer segments with complex issues where our coverage had been minimal due to resource and budget constraints prior to the enactment of the Inflation Reduction Act (IRA). The additional funding would provide us the necessary resources to increase focus on noncompliant priority segments such as large corporations, large partnerships, and high-income/high wealth taxpayers, and the IRS is committed to not increasing audit coverage for small businesses and households below the $400,000/year threshold compared to historic levels. This funding request is expected to produce additional revenue of $3 billion in FY 2029, which will gradually increase to $83.3 billion in FY 2034 with total projected revenue of $341 billion from FY 2029 through FY 2034. The $83.3 billion in revenue projected for FY 2034 comes from a combination of direct revenue ($52 billion), revenue protected via audit ($12.8 billion), increases in efficiency ($11.5 billion), and an estimate of deterrence effect ($6.8 billion).

Question. Of the proposed $104 billion of multiyear supplemental funding for the IRS, you have stated that the funding would, "pay for itself several times over, yielding an estimated $341 billion in revenue."

Assuming such funding was enacted, would taxpayers see measurable Federal revenues result from such funding within 5 years of it being enacted?

If so, how much (broken down by year)?

Answer. The IRS projects total revenue generated by the proposal to be just over $341 billion from FY 2029 to FY 2034. The FY 2029 revenue increase of $3 billion is only for a partial year, as it picks up when the IRA enforcement funds are expected to drop off. The revenue impact in FY 2030 reflects a full year of funding and is correspondingly much higher: $42.7 billion. Revenues then increase more modestly each year through 2034. This proposal is intended to supplement the enforcement work that began with IRA funding and carry it through FY 2034, while simultaneously allowing IRS to continue its modernization and taxpayer services work, which have fiscal cliffs in IRA that arrive much sooner.

Cost $ in Millions	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032	FY 2033	FY 2034	FY 2025 - FY 2034 Total
Taxpayer Services	1,704	1,878	1,913	1,948	1,985	2,022	2,060	2,098	2,138	17,744
Enforcement				1,268	9,611	11,671	11,896	12,126	12,360	58,932
Technology and Operations Support				209	2,848	4,831	5,244	5,289	5,335	23,757
BSM	969	944	264	269	274	279	285	290	295	3,869
Total	**2,672**	**2,822**	**2,177**	**3,694**	**14,718**	**18,803**	**19,484**	**19,803**	**20,128**	**104,302**

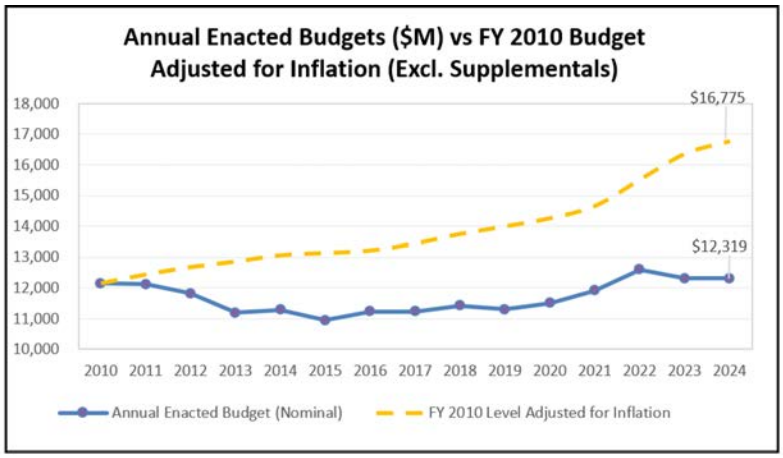
Revenue $ in Millions	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032	FY 2033	FY 2034	FY 2025 - FY 2034 Total
Total Estimated Revenue + Specific Deterrence				**3,046**	**42,692**	**60,911**	**70,717**	**80,000**	**83,647**	**341,013**

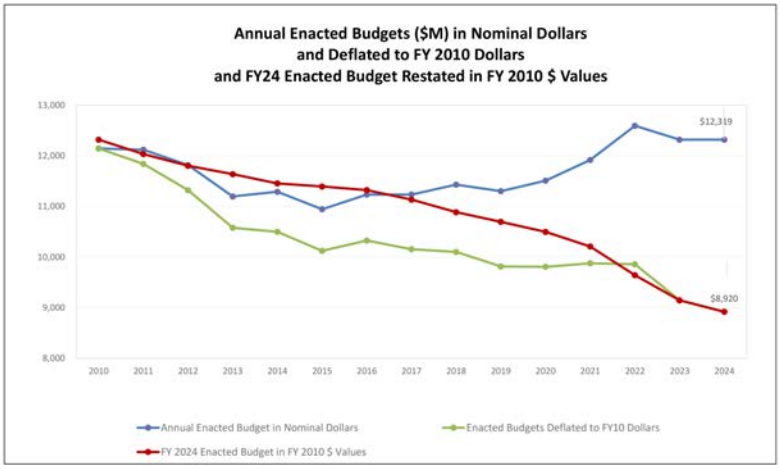
Revenue $ in Millions	FY 2025	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	FY 2031	FY 2032	FY 2033	FY 2034	FY 2025 - FY 2034 Total
Revenue (IRA)											
Direct Revenue					1,258	24,745	37,016	42,831	47,998	49,442	203,291
Soft Notices					475	2,347	2,347	2,347	2,347	2,347	12,209
CI Restitution Paid						180	185	191	196	202	954
Total Direct Revenue (IRA)					**1,733**	**27,272**	**39,548**	**45,369**	**50,541**	**51,991**	**216,454**
Revenue Protected (LB&I)					636	7,824	9,510	9,950	11,014	10,688	49,622
Revenue Protected (W&I)					292	1,516	1,913	2,482	2,556	2,632	11,391
Total Direct and Protected (IRA)					**2,661**	**36,613**	**50,971**	**57,801**	**64,110**	**65,310**	**277,467**
Impact of changing Marginality Assumption (10%) and Assuming Efficiency Gains (10%) for Direct Revenue and Soft Notices											
Direct Revenue & Soft Notices					385	6,020	8,747	10,040	11,188	11,509	47,889
Total Expanded Enforcement Revenue Estimates					**385**	**6,020**	**8,747**	**10,040**	**11,188**	**11,509**	**47,889**
Expanded Enforcement Estimates Total					**3,046**	**42,633**	**59,718**	**67,841**	**75,298**	**76,819**	**325,355**
Deterrence Effect						59	1,193	2,876	4,702	6,828	15,658
Total Expanded Enforcement Estimates + Deterrence					**3,046**	**42,692**	**60,911**	**70,717**	**80,000**	**83,647**	**341,013**

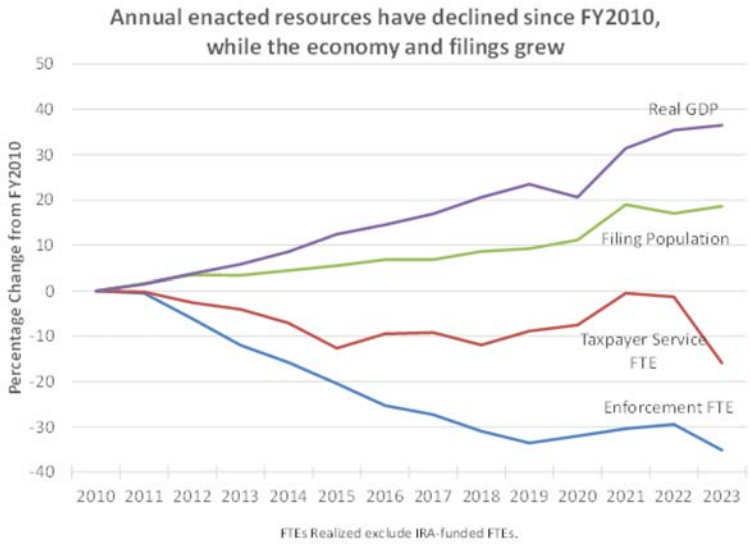
Question. Outside of the Department of Defense, is the IRS aware of any instances in the last 10 Federal fiscal years of appropriated Federal agencies receiving multi-fiscal-year supplemental funding from Congress that equals or exceeds 75 percent of such agency's total annual budget request (net of the supplemental funding, if such was made in the particular budget request) for the fiscal year such funding was requested? If so, please identify each example.

Answer. Based on our research of non-Defense appropriated funding in the past 10 years, the IRS was not able to identify any agency that received multiyear supplemental funding that exceeded 75 percent of its total annual budget request.

The IRS has experienced significant budget reductions since FY 2010. To remain within the budget levels, the IRS was forced to reduce its staff from 93,337 employees in FY 2010 to just 72,803 in FY 2017, a reduction of about 22 percent. The IRS was able to address, to some extent, the staffing crisis in recent years as it received supplemental funding, including IRA funding. However, prior to having IRA investments to help address issues, the significant budget reductions over the years have meant the percentage of millionaires who were audited plummeted to historic lows, service levels were abysmal, many TACs were closed, inefficient paper-based processes persisted across the agency, and old IT did not serve taxpayers well. Additionally, the complexity of tax work has significantly increased with the tax filing population increasing significantly over the years. The charts below provide insight into how the IRS budget changed since FY 2010, a net reduction of more than 26 percent in real dollars, and an overview of how the Gross Domestic Product (GDP) and tax filers have increased and IRS taxpayer services and enforcement employees have decreased since 2010.







Question. How many future years does the IRS currently anticipate asking Congress for multiyear supplemental funding?

Answer. Multiyear funding has been critical in helping the IRS accomplish long-term technology projects and other IRS transformational efforts in the service and enforcement areas. When current multiyear funding is depleted, the IRS will need either higher discretionary funding levels or additional multiyear funding to continue providing the level of service taxpayers expect and deserve and to continue an appropriate level of enforcement with respect to large corporations, complex partnerships, and wealthy taxpayers.

The IRS saw more than a decade of underfunding, with a decrease of more than 26 percent of discretionary funding in inflation-adjusted dollars from FY 2010 to FY 2024. Prior to having IRA investments to help address issues, this reduction has meant the percentage of large corporations, large partnerships, and other complex taxpayers who were audited plummeted to historic lows, service levels were abysmal, many TACs were closed, inefficient paper-based processes persisted across the

agency, and old IT did not serve taxpayers well. The IRA funding is helping restore enforcement staffing, and the current additional multiyear supplemental request will align the funding cliffs of Taxpayer Services, Business Systems Modernization, and Operations Support. Regardless of its source, adequate funding is imperative for the IRS to provide taxpayers with the service they deserve and fairly enforce the law.

Question. Measured in current dollars, and assuming the IRS only has its current funds (annual and multiyear) on hand, what is the IRS's estimate for the total amount of additional funding that it would take to finally adequately modernize all IRS systems? For these purposes, additional funding only includes funding in excess of a projected IRS annual budget for the fiscal year in question, determined by adjusting the actual IRS' fiscal year budget for FY 2022 for inflation.

Answer. In April 2023, the IRS included five major objectives in its strategic operating plan (SOP) to transform the administration of the tax system and the services provided to taxpayers, which was based on receiving $79 billion in IRA mandatory funding plus additional discretionary funding. The plan described how the IRS would transform service to taxpayers by updating technology capabilities and investing in employees with new tools, skills, and capabilities as well as ensured the fairness of the tax system by addressing the tax gap.

Rescissions of IRA funding, which have left a balance of $57.8 billion has put IRS in jeopardy of not achieving this future state. As that reduced balance must be used not only to transform the IRS but also to supplement operational requirements, which will continue to grow as technology is modernized and IRS will have no option but to scale down its work if additional funding is not received. Technology is the foundation of the vision outlined in the SOP and IRS would require additional funding to facilitate the full-scale transformation journey describe as the IRS future state and summarized below.

In short, a transformed IRS is a digital organization that provides taxpayers the ability to engage in tax administration in a completely digital environment if they choose to do so, *i.e.,* every type of engagement, while the premise of a fair and equitable tax system is also present in the compliance aspects of the system for completeness. Therefore, the technology that supports this from end to end must also be modernized or transformed to enable that future transformed state. Existing systems servicing taxpayers and IRS employees cannot be simply modified to deliver this. Replatforming and replacing the custom built for purpose systems on modern platforms with new tools capable of providing a modern digital experience and new capabilities are needed. Additionally, it is expected that work will need to continue in the form of incremental changes over time and beyond this initial transformation/modernization effort, to keep pace as technology changes, so as not to have the need for a major transformation again that stemmed from years of not keeping pace as we have seen historically.

Taxpayer service vision: All taxpayers can meet all their responsibilities, including all interactions with the IRS, in a completely digital manner, if they prefer.

Today, many taxpayers expect to handle all their financial transactions online. While taxpayers will continue to have the option to file their tax returns on paper or reach the IRS by phone or mail, our vision is to offer a seamless and convenient digital experience to the large number of taxpayers that prefer online. In addition, Call Center modernization is focused on leveraging technology, such as voicebots, that will route calls based on human language to make the call centers even more efficient. Automated answering of calls frees up employees from answering basic questions addressed by bots and allows taxpayers to obtain faster service. The IRS launched The Simple Notice Initiative and will review and redesign hundreds of notices with an immediate focus on the most common notices that individual taxpayers receive. This initiative coupled with the IRS Paperless initiative provide taxpayers the option to go paperless and conveniently submit necessary responses online. Having digital versions of notices online will also help taxpayers verify that the notices they receive in the mail are legitimate. Our vision is to have online self-service options for all taxpayer needs. Future investments into our technology will further enable taxpayers to access their information in real time.

Once these efforts are completed, they will increase employee capacity for areas where taxpayers need the most help and assist with more complex issues, especially in addressing tax scams and schemes, and claiming credits and deductions.

Fairness in enforcement vision: Noncompliant taxpayers, including some of the largest and most complex filers, pay what they owe because the IRS has the

workforce and advanced technology needed to enforce fairness in the tax system and narrow the tax gap.

IRS is using modernization to rebalance our enforcement focus to boost enforcement capability for the most complex, high-income taxpayers. Advanced compliance analytics will ensure the IRS is detecting high-risk noncompliance effectively and will empower employees to work more efficiently. This will ensure the IRS has the capability needed to tackle new issues as the tax administration landscape continues to become more complex include investing in training so that our workforce has the necessary capabilities to tackle increased complexity. Better analytics will also allow IRS to minimize auditing taxpayers where they are found to be compliant upon completion of the audit, avoiding time-consuming audits and focusing resources on noncompliance among complex, high-income taxpayers.

Cybersecurity and data protection focus: Taxpayer privacy and security will remain paramount in all we do. Modernization encompasses implementing new technology capabilities faster, at a larger scale with better reliability and cybersecurity built in, so taxpayers can seamlessly access their data and rest assured that their data is protected and secure. With the latest cybersecurity implemented and always staying ahead, the IRS can detect and address issues before they interrupt services.

Cybersecurity and data protection must keep pace with new threats, technologies, and architectures, this can be achieved by maintaining currency with our infrastructure and cybersecurity posture. We already identify, assess and respond to security risks, but our efforts must increase to protect many more cloud vendors and solutions, taxpayer interaction types and employee data access capabilities. Modernization will continue to scale data encryption across dozens of systems to limit exposure of taxpayer data. We will continue to espouse a continuous, proactive, and adaptive security posture through a zero-trust model, which will allow IRS to reduce fraud and better protect the system from cyberattacks ensuring taxpayers can continue to trust that their information and identities are protected.

Information technology vision: Technology is modern, scalable, and easy to maintain to meet IRS mission. Data is easily accessible and used in an innovative way.

To achieve the visions above and cybersecurity and data protection focus, there is a need for a modernized robust technical foundation at the IRS that will improve the efficiency, performance, and accessibility of its information technology systems. The foundational technology infrastructure, data, systems, and network are critical to enabling services and enforcement efforts, while ensuring core IRS operations remain resilient and secure. The IRS needs to continue modernizing the legacy footprint (which includes aged programming) from the point of intake of tax returns and information systems through processing and ultimately retention. Data access and security will be integrated in each instance to ensure we retain the integrity of the tax system and secure taxpayers' information. A modernized IRS information technology echo system would provide real-time updates to taxpayers, improve transparency, and offer advanced tools for employees, ultimately creating a more efficient, secure, agile, and taxpayer-focused organization.

Question. With respect to the funding provided to the IRS as part of the Inflation Reduction Act, would the IRS support receiving transfer authority for any such funding? If so, how much transfer authority would the IRS suggest, and with respect to which accounts?

Answer. Multiyear funding has been critical in helping the IRS accomplish long-term technology projects and other IRS transformational efforts in the service and enforcement areas. When current multiyear funding is depleted, the IRS will need either higher discretionary funding levels or additional multiyear funding to continue providing the level of service taxpayers expect and deserve and to continue an appropriate level of enforcement with respect to large corporations, complex partnerships, and wealthy taxpayers. The FY 2025 budget proposed $12.3 billion in discretionary funding for FY 2025 and $104 billion in additional mandatory funding for the IRS between FY 2026 and FY 2034, including $17.7 billion for taxpayer services, $58.9 billion for enforcement, $23.8 billion for technology and operations support, and $3.9 billion for business systems modernization. In conjunction with this proposal, the administration also proposed expanded transfer authority to allow the IRS to deploy the resources Congress has provided effectively. But without the additional funding proposed in the budget, transferring resources from other accounts to taxpayer services would shortchange other critical activities and accelerate other

funding cliffs. In particular, it would likely accelerate the enforcement funding cliff into the 2020s and/or force the IRS to cut back on planned investments with high rates of return for the Federal budget.

Question. The IRS budget projects that the proposed $104 billion would generate approximately $341 billion in revenue, while providing, among other things, "equitable enforcement activities that minimally burden taxpayers."

Can you provide examples of these "equitable enforcement activities" and how they would impact taxpayers?

Answer. The IRS will increase fairness for all taxpayers and address the tax gap by focusing more resources on priority taxpayer segments, including large partnerships, large corporations and noncompliant high-income and high-wealth individuals, that disproportionately contribute to the tax gap. We are also working to improve enforcement in areas of non-income taxation (excise, employment tax, and estate and gift) and emerging issues such as digital assets. Specific examples include:

- Ramped up efforts to pursue noncompliant high-income, high-wealth individuals who have either not filed their taxes or failed to pay recognized tax debt, concentrated among taxpayers with more than $1 million in income and more than $250,000 in recognized tax debt.
- Opened examinations of 76 of the largest partnerships in the U.S., representing a cross section of industries including hedge funds, real estate investment partnerships, publicly traded partnerships, large law firms and other industries.
- Expanded the large corporate compliance (LCC) program, focusing on noncompliance by using data analytics to identify large corporate taxpayers for audit. LCC includes the largest and most complex corporate taxpayers with average assets of more than $24 billion and average taxable income of approximately $526 million per year.
- Increased audits involving personal use of business aircrafts. The audits focus on aircraft usage by large corporations, large partnerships, and noncompliant high-income taxpayers. We will examine whether the use of jets is being properly allocated between business and personal use.

Question. Would any of the estimated $341 billion in purported revenue come from taxpayers earning less than $400,000?

Answer. The IRS is committed to not increasing audit coverage for small businesses and households below the $400,000/year threshold compared to historic levels.

Question. Congressional Budget Office (CBO) rules prohibit scoring hoped-for but entirely uncertain revenue from proposed enforcement.

Has the IRS projection of the $341 billion in revenue been evaluated by the nonpartisan CBO?

If not, does the IRS believe that based upon past practices CBO would confirm that amount?

If not, does the IRS believe that based upon past practices the amount CBO would project would be higher or lower than the $341 billion projection?

Answer. The IRS collected $4.034 billion dollars on behalf of the United States in FY 2023. The vast majority of what the IRS collects is paid "voluntarily and timely" and many of IRS's operational activities exist to collect that revenue. These include significant service and technology activities to assist taxpayers and accept and track tax revenue. IRS enforcement exists primarily to encourage and promote voluntary and timely compliance and, secondarily, to collect revenue from those who do not accurately and timely file and pay their taxes. In FY 2023, total enforcement revenue collected was $86 billion or 2 percent of total collections.

The IRS recently published a white paper that discusses how the focus on IRS enforcement almost certainly underestimates the actual revenue benefit to the United States of America that investing in the IRS will have. As described in the IRS strategic operating plan, the IRS is investing in the full spectrum of its activities, including service, technology and enforcement. While $341 billion seems like a lot, when taken in context, as a multiyear estimate of the proceeds of maintaining a transformative investment for the IRS—an organization which was already col-

lecting $4 billion annually pre-transformation—it is a modest and likely conservative estimate for the increased revenue from that investment.

CBO analyses consistently show that investing in the IRS produces more revenue for the United States than it costs. However, we would refer you to CBO for their analysis of any specific proposal.

Question. Of the $80 billion of funding for the IRS provided in the IRA, more than half—$46 billion—was allocated to enforcement, while only 4 percent was provided to taxpayer services. In your testimony before the committee, you noted supplemental funding is needed for both modernization and customer service.

In addition, Treasury Inspector General for Tax Administration (TIGTA), keeps track of the IRS's spending of IRA funding, but this tracking is only updated every 3 months (with the latest TIGTA figures reflecting spending as of December 31, 2023).

Beyond the data reported by TIGTA as of December 31, 2023, how much of the IRA funding allocated to enforcement has been spent?

Beyond the data reported by TIGTA as of December 31, 2023, how much of the IRA funding allocated to taxpayer services has been spent?

Beyond the data reported by TIGTA as of December 31, 2023, how much of the IRA funding allocated to modernization has been spent?

Do you believe the IRA struck the optimum balance in its allocation of funding between enforcement versus modernization and taxpayer services?

If IRA funding allocated to enforcement currently remains unspent, and is not projected to be spent within the next 2 years, would any of those funds be more effectively used by being allocated to modernization or customer service?

Answer. IRS provides quarterly reporting on IRA spending. Below is the most recent report from the fourth quarter of Fiscal Year 2024, which is also posted on the IRS website at IRS financial reports. The IRS has obligated a total of $1,634.3 million of IRA enforcement allocation through September 30, 2024.

Management Quarterly Update

Fiscal Year 2024 Quarter 4 Update

The Management Quarterly Update is a supplemental document to the IRS Agency Financial Report, Management's Discussion and Analysis section to provide transparency on the IRS's management and operational challenges. The Fiscal Year 2024 Quarter 4 update includes a table describing the IRS's Inflation Reduction Act of 2022 (IRA) spending.

IRS's IRA Spending as of September 30, 2024

(in millions)

Appropriation	Appropriated Funds	FY22 Spent	FY23 Spent	FY24 Apportioned	FY24 Spent	FY22–FY24 Spent
Taxpayer Services	$3,181.5	$1.1	$888.5	$969.3	$402.5	$1,292.1
Enforcement	$24,047.9	$0.0	$299.0	$1,347.6	$1,335.3	$1,634.3
Operations Support	$25,326.4	$61.0	$1,473.8	$3,258.5	$2,456.2	$3,991.0
Business Systems Modernization	$4,750.7	$43.9	$723.2	$1,789.4	$1,282.0	$2,049.0
Direct e-File Study	$15.0	$0.0	$11.6	$0.0	$0.0	$11.6
Energy Security	$500.0	$0.0	$0.0	$180.0	$59.1	$59.1
Total	**$57,821.5**	**$106.0**	**$3,396.1**	**$7,544.8**	**$5,535.1**	**$9,037.2**

Notes: Enforcement appropriation is adjusted for $1.48 rescission from the Fiscal Responsibility Act of 2023 (Public Law 118–5) and $20.28 from the Further Consolidated Appropriations Act, 2024 (Pub. L. 118–47).
Direct e-File Study funds were only appropriated through FY23.
FY24 apportionment amount does not include prior year accounting adjustments.

Source: FY24 End of Year Actuals Obligations Expenditures and Disbursements report.

This allocation allows the IRS to increase enforcement in priority segments such as large corporations, large partnerships, and noncompliant high-income/high-wealth taxpayers to generate revenue and enforce the tax laws. IRS intends to utilize all the remaining funding allocated to enforcement to right-size enforcement staffing, which has suffered from more than a decade of underfunding.

The FY 2025 budget proposed $12.3 billion in discretionary funding for FY 2025 and $104 billion in additional mandatory funding for the IRS between FY 2026 and FY 2034, including $17.7 billion for taxpayer services, $58.9 billion for enforcement, $23.8 billion for technology and operations support, and $3.9 billion for business systems modernization. This funding would allow the IRS to provide taxpayers with the service they deserve and fairly enforce the law.

Question. Please list all of the ways that the IRS currently utilizes, or anticipates to start utilizing in the next 2 fiscal years, artificial intelligence (AI) and/or machine learning.

Answer. As of June 20, 2024, the IRS has 84 active AI use cases in our internal AI use case inventory, 37 of which are currently used in an operational workflow. All AI use cases must meet governance requirements that align with OMB, Treasury, and IRS standards before they are approved for use. Broadly speaking, the IRS is using AI for three purposes:

1. TO IMPROVE TAXPAYER SERVICES

Examples: Using chatbots to address taxpayer questions online and provide general FAQ-type information, and voicebots to answer taxpayer questions over the phone and provide general information along with some account-specific information. These bots are designed to be more user-friendly than legacy, menu-driven phone assistance and reduce wait times to speak with a live agent. Note: all chatbot and voicebot responses are predetermined by IRS business owners; responses to taxpayers are *not* produced by generative AI. We also use AI and other advanced analytic methods to identify taxpayer pain points and help develop targeted service improvement strategies.

2. TO IMPROVE EFFICIENCY OF INTERNAL BUSINESS OPERATIONS

Examples: Using machine translation systems that decrease the time required to translate some public-facing documents from English to Spanish and other languages. All output is reviewed by a bilingual human translator prior to publication. The IRS has deployed internal chatbots to help answer employee IT questions or learn about job-related benefits. IRS employees can also use internal machine translation software to translate case related documents to English. We have also used sophisticated AI techniques to generate insights from documents and memoranda and use those insights for training new staff in the compliance domain.

3. TO DETECT TAX NONCOMPLIANCE AND FRAUD, INCLUDING IDENTITY THEFT

AI is used to help identify fraud (*e.g.,* returns filed using other taxpayers' personally identifiable information), and to identify potentially high-risk cases that may warrant examination. All model outputs are reviewed by humans and used to inform human decision-making; decisions to conduct an audit are made by humans, and audits are performed by humans. IRS does not use AI to audit taxpayers.

Examples: AI models are used to improve IRS ability to detect potential tax fraud or noncompliance on complex tax returns filed by large corporations and large partnerships.

Anticipated future use: The IRS recognizes that generative AI has great potential but must be used carefully to ensure outputs are accurate and trustworthy. The IRS is exploring use cases such as:

- Summarizing document content, such as logs of customer contacts or documentation provided with tax returns to better understand taxpayer concerns.
- Assisting IRS notice writers and content developers by producing first drafts of new materials, which IRS subject matter experts will review before taxpayers receive them.
- Expanding chatbot capabilities to help taxpayers get answers to questions.
- Improving search and summarization of employee training materials, knowledge artifacts and the Internal Revenue Manual.

- Assisting audit examiners by helping to translate case notes into final reports and usable data on the audit outcome as well as models to improve our ability to identify noncompliance on complex tax returns from high-income filers are in development.

Note: None of these anticipated future use cases are currently being used in production.

Question. Please list all of the policies the IRS currently has in place, or anticipates having in place in the next 2 fiscal years, that will (or would) govern its utilization of AI or machine learning.

Answer. AI capabilities can be delivered into the enterprise through multiple avenues, including internal development of machine learning/AI models, inclusion of commercial or open-source AI components in technology solution architectures, or updates/releases of commercial technology systems that include new AI functionality. To help ensure that third-party AI components are being properly governed, the IRS has updated its existing information technology governance processes for the software development lifecycle ("OneSDLC") and technology insertion ("Tech Insertion"). Both the OneSDLC and Tech Insertion processes now include steps to capture new AI use cases for IRS AI inventory. Project teams engaged with OneSDLC and Tech Insertion are directed to follow IRS AI Governance process to support the development of artifacts for ongoing review including use case risk assessments, model cards, and data sheets.

In May 2024, the IRS issued interim guidance codifying our AI governance policy (RAAS–10–0524–0001, Artificial Intelligence Governance and Principles) (May 20, 2024) (RAAS–10–0524–0001).[6] It codifies Federal requirements such as the AI use case inventory and OMB M–24–10[7] minimum practices for rights-impacting or safety-impacting AI, along with establishing an IRS-wide AI governance process that includes multiple levels of human review and artifacts that must be completed for each use case. All rights- or safety-impacting AI use cases require executive board approval prior to being authorized for use in an operational workflow.

In addition, the IRS is bound by the decisions rendered by the Treasury Artificial Intelligence Governance Board (AIGB), in which the IRS is a standing member. The AIGB helps ensure AI is implemented within the Department in a manner consistent with the Department's risk appetite, with appropriate considerations given to safety and equity.

Question. The House Judiciary, Ways and Means, and Oversight and Accountability Committees have been informed that the IRS may be investigating IRS agents Gary Shapley and Joseph Ziegler, who reported concerns to Congress about the handling of the Hunter Biden case. Reports suggest this investigation might be in retaliation for their lawful disclosures.

These allegations are particularly alarming in light of claims reported by *The New York Times* that Hunter Biden's lawyers have accused the whistleblowers of illegal disclosures and urged their prosecution. I am concerned by the possible misuse of investigative power as a means of punishing these individuals for their protected actions.

Could you provide an update on the status of the investigations into agents Shapley and Ziegler, especially in relation to claims of whistleblower retaliation?

How is the IRS ensuring its adherence to Federal whistleblower protection laws?

Answer. The IRS has not conducted any investigation of Shapley or Ziegler, nor would there typically be an investigation of IRS personnel in the circumstances described above. We have long believed it is essential to good government that public-sector employees have ample mechanisms available to report potential concerns—and that employees feel comfortable and secure making such reports.

As a general matter, when there are concerns or allegations of potential unlawful activity by IRS personnel relating to their tax administration duties—which could include allegations of unlawful tax disclosure, allegations of retaliation or other prohibited personnel practices, or any other violation of law, regulation, or duty—it is

[6] This policy is available to the public on the *irs.gov* FOIA library at *https://www.irs.gov/pub/foia/ig/spder/interim-guidance-raas-10-0524-0001-artificial-intelligence-governance-and-principles-redacted.pdf.*

[7] *See* OMB Memorandum titled "Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence, March 28, 2024, OMB Memorandum M–24–10 (OMB M–24–10) at OMB M–24–10.

IRS's standard practice to refer these matters to TIGTA. This places the decision on whether to pursue an investigation, not with the IRS, but with an independent and separate authority. The IRS then awaits any appropriate guidance or recommendations from TIGTA and acts, as warranted, with the benefit of TIGTA's fact-finding and analysis. This approach is consistent with Department of Treasury Order 115–01 (May 24, 2018), and it ensures that the relevant questions are independently reviewed, in a manner that is protective of our mission, complies with all legal obligations, and safeguards the rights of the relevant employees and of any impacted taxpayers. As a result, and as stated above, there has not been, nor is there, any IRS investigation of the two employees referenced above.

Question. This past December, the Treasury Inspector General for Tax Administration (TIGTA) released a report concluding the IRS is not in compliance with the No TikTok on Government Devices Act. TIGTA's reported TikTok was found on devices used by employees in the IRS's Criminal Investigation division, for example.

Could you describe the IRS policy of letting IRS employees use their personal devices to handle highly sensitive and legally protected taxpayer information?

Answer. The IRS Bring Your Own Device (BYOD) program is a voluntary program that allows personnel to use their personally owned mobile devices to stay connected to, access data from, or complete many IRS tasks. Internal Revenue Manual 10.5.1.6.13 (September 15, 2023), Bring Your Own Device, provides an overview of the BYOD program and the related requirements to protect highly sensitive and legally protected taxpayer data.

To protect the privacy of the tax information, BYOD participants must only use IRS-approved applications provided by IRS through a secure container on the device. They must also adhere to all applicable laws, regulations, rules, policies, and procedures, including the Federal Records Act, Office of Government Ethics Standards of Ethical Conduct, and the Department of Treasury's Employee Rules of Conduct. In addition, BYOD users must consent to monitoring, interception, recording, reading, copying or capturing by authorized personnel of all activities on the IRS-approved mobile device business software on their mobile devices.

To access IRS resources, the user must have their device enrolled in the BYOD program, have the container software installed, and use both a passcode to unlock the device and a password when using an application within the container to access IRS data. The applications used within the container and information accessed on the personal device is encrypted and fully separate from the user's personal applications and data. If the device is lost or stolen, the user is required to report the theft immediately.

With respect to IRS Criminal Investigation, consistent with Office of Management and Budget (OMB) Memorandum M–23–13, "No TikTok on Government Devices Implementation Guidance," which "permits limited exceptions to the restrictions outlined in this memorandum for law enforcement activities, national security interests and activities, and security research," a limited subset of employees in the IRS Criminal Investigation Division (CI) are able to access TikTok through an isolated, secure, and compartmentalized third-party solution for legitimate investigative purposes. IRS CI employees cannot access the TikTok website or download or install the TikTok app on their agency mobile devices or computers.

Question. Why did TIGTA find TikTok, which is infamous for collecting data from mobile phones, on the same mobile phones that handle highly sensitive and legally protected taxpayer information?

Answer. The IRS is committed to ensuring devices used to access IRS systems do not have TikTok installed and can neither install the application nor access the TikTok website. IRS has control over IRS-issued devices, and we prevent both installing the TikTok application and accessing the TikTok website on IRS devices. The IRS also has control over the secured, encrypted container on employee devices enrolled in the IRS's BYOD program, and TikTok cannot be installed in or accessed from the secure container. Although the IRS manages the secure portion of the device that contains IRS applications and data and the IRS prevents the copying or sharing of data between that container and other applications on the device, we do not have the ability to control what applications BYOD users install or what websites they access on their personal devices outside the secure IRS BYOD solution.

Question. The IRS received approximately tens of billions of dollars in multiyear supplemental funding. Why do IRS employees need to use their own mobile phones

to handle highly sensitive and legally protected taxpayer information? If an IRS employee needs a mobile phone, why can't the IRS provide the employee with a secure mobile phone?

Answer. The IRS conducted an assessment of BYOD opportunities and determined the program could save budget resources without sacrificing data security. By deploying BYOD, the IRS saves money by not purchasing a fleet of mobile devices and supporting cell-phone data packages. The IRS avoids not only up-front device and data costs but also the expenses for smartphone refreshes, software updates, and repairs. In a BYOD program, users simply add secure functionality to devices they already own and maintain.

The BYOD program also improves productivity, connectivity, and employee satisfaction. In the event of tasks that need immediate approval or a work-related emergency, it's crucial to reach key employees immediately. Employees typically have their personal devices available, and employees who utilize the BYOD program are more likely to be able to access work materials at all times than users with a dedicated work device.

The BYOD program provides savings for the IRS and better access for employees. It provides convenience for employees who don't have to manage multiple mobile phones.

Question. "Troves" of taxpayer information have been leaked by IRS-hired contractors. There is *The New York Times* and *ProPublica* leak of IRS contractor Charles Littlejohn. Then there is the astonishing double leak by the IRS of legally protected taxpayer information on Form 990–T. This particular leak was first reported in September 2022 and then, after telling us this would never happen again, it happened again as reported in December 2022. And again, the IRS blamed this double leak on an IRS contractor.

What is the IRS doing to stop contractors it hires from leaking private taxpayer information?

Answer. When I arrived as IRS Commissioner in March 2023, safeguarding taxpayer information was a priority for me, and I quickly focused on using new Inflation Reduction Act resources to bolster the agency's data security. In addition to reviewing the report, the IRS has taken multiple steps to improve the safeguarding of taxpayer data. These measures include:

- **Further restricting user access.** We restructured our operations to reduce the number of people with access to the most sensitive taxpayer datasets. Stronger protocols are now in place to ensure only people with documented, mission-essential needs are entitled to receive access.
- **More robust protective security controls.** We updated data protection mechanisms (*e.g.,* encryption, anonymization) to better protect taxpayer information.
- **More frequent data entitlement reviews.** We are strengthening review protocols to ensure more IRS oversight of data users, have implemented procedures to ensure that all network access is timely removed for users who separate from the IRS. So far, we have reduced timeframes for deactivating inactive accounts assigned to current employees and contractors by 25 percent. Managers are required to review and approve initial requests for access and to periodically validate continuing user need for the access. IRS Cybersecurity will conduct additional reviews to ensure we limit access to key sensitive systems to properly authorized individuals.
- **Collection and retention of detailed access logs.** Key data sources inside the IRS have improved monitoring and event logs. We now maintain evidentiary copies of database queries and data outputs, which improves surveillance of internal data use and preserves records of who accessed which data and when. Additionally, we enforce an approved destination for data exports and prevent users from copying those files to unapproved drives and/or folders.
- **Improved firewalls.** We have added additional firewalls between key taxpayer information and the rest of the IRS, providing additional monitoring capabilities. We record all traffic between these areas to improve monitoring.
- **Stronger 24/7 monitoring.** We have expanded advanced analytics to detect and prevent risky data usage, providing improved insight into suspicious activities around the clock.

- **New tools.** We are adding new analytical tools and dashboards to monitor user activity involving sensitive data. These tools will help to improve the detection of potential data misuse.
- **Less removable media.** We have dramatically reduced users' ability to connect removable media, such as thumb drives, to IRS computers. The new protocol requires executive approval of those users who have legitimate business needs and close monitoring of user activity to watch for risky behavior. This step has significantly curtailed opportunities to remove sensitive taxpayer information from the IRS computing environment.
- **Tighter email controls.** We have dramatically strengthened email controls involving taxpayer information, including new restrictions on contractors' ability to email information outside the IRS, while preserving but closely monitoring this ability when necessary for collaborating with non-IRS employees. This step has further reduced the risk of contractors removing sensitive taxpayer information from the IRS computing environment.
- **New printer controls.** We are now logging and scanning printing by all IRS users to detect potential policy violations and to preserve evidence to support inquiries of suspected wrongdoing. This effort includes printing at telework/remote work locations.

Question. What consequences have there been for the consulting firms involved in leaking taxpayer data?

Answer. Mr. Littlejohn was found guilty of disclosing tax return information without authorization and was sentenced to prison. His actions were criminal, intentional, and accomplished using sophisticated methods to try and avoid detection. They were the actions of one criminal individual.

The IRS is not aware of any consulting firms involved in intentionally leaking taxpayer data.

Question. Is the IRS using any of its supplemental IRA funding to continue to pay any consulting firms whose employees leaked private taxpayer information?

Answer. The IRS must follow Federal Acquisition Regulations (FAR). Under the FAR, the indictment or conviction of a consulting firms' employee would not automatically negate contractual agreements. As detailed above, the IRS has made significant improvements to our taxpayer data protections, including closing access and exfiltration opportunities this sophisticated insider used to collect and remove data and try and hide his criminal unauthorized access and disclosure.

Question. You and your staff have conveyed that the IRS will endeavor to implement any law changes from H.R. 7024 as expeditiously as possible.

You have provided in writing that it will take approximately 6–12 weeks to make software and programming changes and process second refunds. However, you and your staff have also conveyed that these second refunds will come in the form of paper checks. I understand that the Bureau of Fiscal Services is responsible for issuing those checks, and that it will take them another 5–6 weeks to process them.

Is that timeline accurate or are there any updates to this information that you can share?

Answer. The timeline needed of approximately 6–12 weeks from the date of enactment to adjust systems and issue paper payments is still accurate, while noting the potential for unforeseen events that could affect timing. After further analysis and study, the IRS will be able to issue refunds as direct deposit when banking information is available from the 2023 tax return. This will reduce the volume of paper checks issued from the Bureau of the Fiscal Service.

The IRS is positioned to implement laws enacted by Congress as quickly as possible. The IRS will move with urgency to ensure taxpayers and tax professionals are informed, and that those lawfully entitled to a benefit due to enacted tax code changes are able to receive that benefit.

Question. Amid concerns about fraudulent ERC claims, on September 14, 2023 the IRS enacted a moratorium on processing new claims. When the moratorium took effect, it was estimated the IRS paid $230 billion in Employee Retention Credits. The moratorium appears to be driven by three factors. First, the IRS and some tax professionals believe a vast majority of ERC claims are ineligible. Second, initial estimates placed the ERC's cost at about $78 billion, yet current estimates suggest it

could exceed $550 billion. Third, fraudulent promoters have misled honest small business owners into applying for the credit.

As a result of the moratorium, it is estimated more than 1 million ERC claims await processing. Separately, the IRS has promoted an ERC Voluntary Disclosure Program (VDP), which ended March 22, 2024.

What percentage of ERC claims overall does the IRS believe to be ineligible for the credit, and how many have been paid?

Answer. The Employee Retention Credit (ERC) is a complex claim with precise requirements to help businesses during the pandemic. Amended returns from ERC applicants come in on paper. During the moratorium, the IRS transcribed data from approximately 1 million claims and analyzed the data to evaluate the risk of ineligibility. The moratorium provided valuable time to determine the risk profile of these claims. This analysis shows that 10–20 percent of the 1 million transcribed claims were in the highest-risk group, while potentially 60–70 percent have an unacceptable level of risk and cannot be processed without further analysis.

Throughout the moratorium, the IRS continues to work ERC claims received prior to the moratorium and to pay out claims, select potentially ineligible claims for audit and issue notices of claim disallowance for ineligible claims. In addition, we have undertaken an array of compliance initiatives around erroneous ERC claims, to include Voluntary Disclosure Program, withdrawal process, and disallowances, topping more than $2 billion since last fall. These ERC initiatives are working to protect businesses from ERC promoters that shared misleading information or misrepresented eligibility rules and lured businesses to apply for the ERC when they did not qualify. IRS efforts have confirmed inappropriate claims across several compliance programs:

- More than 2,600 applications for the special ERC VDP disclosed more than $1 billion.
- The ongoing claim withdrawal process for those with unprocessed ERC claims has led to 7,300 entities withdrawing $677 million as of August 15, 2024. The IRS has determined that more than 12,000 entities filed over 22,000 claims that were improper and resulted in $572 million in assessments. The IRS is continuing this work, and more activity is planned in this—and other areas in the months ahead.

Question. What percentage of pre-moratorium ERC claims does the IRS believe were ineligible for the credit, and how many were paid?

Answer. During the moratorium review period, the IRS digitized and analyzed more than 1 million ERC claims (all of which were paper returns) representing more than $86 billion. In June 2024, we announced our findings, which confirmed concerns raised by reputable tax professionals and others that there was a high rate of improper claims in the inventory:

- Between 10 percent and 20 percent of claims fall into what we have determined to be the highest risk of being ineligible.
- Between 60 percent and 70 percent of the claims showed an unacceptable level of risk and further analysis was needed.
- Between 10 percent and 20 percent of the ERC claims showed a low risk of being ineligible.

Question. Why did the IRS wait until September 14, 2023 to institute a moratorium to address the problem of ineligible claims?

Answer. The IRS wants to prevent businesses from being misled while ensuring that businesses that make legitimate claims receive the credits they are entitled to receive. Despite what these ERC promoters promised, this tax credit is not a risk-free way to get money from the government. Businesses putting in claims could be putting themselves at financial risk. Nearly 2 years removed from the heart of COVID–19 economic disruptions, we observed an increase in the number of ERC claims being filed that seemed to have been influenced by aggressive marketing. During this time, ERC claims filing increased, averaging 50,000 to 60,000 claims weekly. We feared that too many honest small businesses were being put at risk to the benefit of unscrupulous promoters that received a contingency fee of up to 20 percent of the refund being claimed.

The IRS initiated the moratorium following these growing concerns inside the agency, as well as from tax professionals and media reports, that a substantial share of new ERC claims, filed well after the legislation had passed were ineligible.

As stated above, the moratorium provided valuable time to risk assess the inventory. It also slowed the filing of ERC claims dramatically—they dropped by about half, to about 30,000 a week.

Question. When was the earliest point where an IRS employee raised concerns to the IRS Commissioner, Deputy Commissioner, or any IRS Chief, Division Commissioner, Director, or other senior IRS official with respect to IRS actions or policies in paying ERC claims?

Answer. In the winter of 2022 and spring of 2023 the IRS leaders attempted to alert taxpayers to potential abuse of the ERC. See news release: IRS issues renewed warning on Employee Retention Credit claims; false claims generate compliance risk for people and businesses claiming credit improperly, Internal Revenue Service. By the summer of 2023, IRS officials were hearing concerns first-hand from the tax professional community that high volumes of the claims being filed were ineligible.

Question. Did any senior IRS official listed in the prior question ever advocate for imposing a moratorium on the payment of ERC claims prior to August 15, 2023? If so, what was the earliest instance that such occurred?

Answer. In the summer of 2023, IRS officials were hearing concerns firsthand from tax professionals that an estimated 95 percent of these claims being filed at that time were ineligible. This concern was based on the tax professionals' clients who were ineligible for the ERC but were going to promoters/preparers and having ERC claims prepared and filed. Discussions began about what actions should be taken to protect businesses and protect the public fisc from improper claims for tax refunds.

Question. What steps has the IRS taken to recover ERC payments made to ineligible claimants? How do these steps protect eligible ERC claimants from unnecessary inquiries?

Answer. As noted earlier, we have undertaken an array of compliance efforts around erroneous ERC claims that have topped more than $2 billion since last fall. Specifically, within those efforts, before the expiration of the assessment statute for tax year 2020 claims, we assessed $572 million in involving 12,000 entities due to the claims being improper. We also announced that taxpayers that want to participate in the ERC VDP were required to voluntarily pay back 80 percent of the ERC received, cooperate with any requests from the IRS for more information and sign a closing agreement. This program, which was available through March 22, 2024, resulted in the disclosure of more than $1 billion from over 2,600 taxpayers who opted to participate.

Question. How many IRS employees are dedicated to recovering money paid to ineligible ERC claims?

Answer. The IRS has trained over 50 employees to perform efforts to recapture ERC claims that were paid in what has subsequently been identified to be excessive or erroneous amounts.

Question. What specialized training is provided to IRS employees tasked with retrieving ERC funds that were paid to ineligible taxpayers? How does such training educate IRS employees to identify eligible ERC claims thereby acknowledging a valid claim?

Answer. The IRS is deploying data analytics across paid claims to identify those deemed excessive or erroneous. Employees who work the output of these analytics are being trained in general criteria for eligibility. Additionally, revenue agents who work audits of ERC receive training on ERC eligibility and apply it to any active audits.

Question. What is the return on investment on tax enforcement resources assigned to pursuing invalid ERC claims?

Answer. As noted above, our special compliance efforts have yielded more than $2 billion since fall. This far exceeds the cost of our resources.

Question. Is the IRS planning to allocate more enforcement resources to pursue ineligible ERC claims?

Answer. We are planning to continue our existing efforts, and more activity is planned in the months ahead.

Question. How many taxpayers applied for the VDP?

Answer. As noted above, 2,600 taxpayers opted to participate in the special ERC VDP, yielding more than $1 billion.

Question. How many taxpayers did the IRS accept into the VDP?

Answer. Applications are still actively being reviewed.

Question. How much money was recovered by the VDP?

Answer. Due to the ongoing processing of VDP applications, this information is not available. As noted above, more than 2,600 applications for the special ERC VDP disclosed more than $1 billion. The Service is currently receiving applications for the second ERC VDP.

Question. Of the recovered amount, how much will be recovered through installment payments?

Answer. Due to the ongoing processing of VDP applications, this information is not currently available.

Question. When do you anticipate resuming pre-moratorium ERC claim processing levels?

Answer. During the moratorium review period, the IRS digitized and analyzed more than 1 million ERC claims (all of which were paper returns) representing more than $86 billion. In June 2024, we announced our findings, which confirmed concerns raised by reputable tax professionals and others that there was a high rate of improper claims in the inventory.

In August, we announced that we are now processing claims based on our risk analysis of the approximately 1.2 million pre-moratorium claims, and we moved the date of the moratorium to claims filed as of January 31, 2024. We began processing on about 400,000 claims filed up to this new date, representing about $10 billion of eligible claims. We have continued and will continue until the end of the calendar year to process both allowance and disallowance claims of pre-moratorium claims.

Question. When do you estimate the backlog of ERC claims will be processed?

Answer. We are moving as rapidly as possible while still ensuring that ineligible claims are not being paid. There will be significant movement of the inventory by the end of FY 2025.

Question. How much do you estimate will be paid to ERC claimants once the moratorium is lifted?

Answer. We cannot provide an estimate at this time.

Question. Does this amount include interest accrued to the delay caused by the moratorium?

Answer. We cannot provide an estimate at this time.

Question. If the moratorium were to be lifted on June 30, 2024, what would the interest rate be for a valid ERC claim received on the first day of the moratorium?

Answer. The IRS pays interest at a rate dictated by section 6621 which is subject to change every calendar quarter. The answer to the question depends on which calendar quarter the ERC was claimed, and if it was claimed on a timely filed return.[8]

Question. Considering the Commissioner described finding an eligible ERC claim is like finding "a needle in a haystack," how is the IRS ensuring the integrity of the tax system by only paying valid ERC claims? Due to the importance of this question, please provide a detailed answer.

Answer. The goal of closing one-third of the inventory includes claims that will be disallowed and those that will be allowed. The remaining claims in inventory require additional steps to unlock the complexity and determine eligibility. We are adjusting our risk scoring as taxpayers respond to disallowance letters and to audits. The work will proceed in a way that balances the need for claimants to have closure and to avoid improper payments.

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[8] For interest computation information, you can find more information at *https://www.irs.gov/payments/quarterly-interest-rates*.

Question. Before issuing moratorium-delayed ERC payments, has the IRS considered a large-scale campaign to ask ERC claimants for more information to better filter the eligible from ineligible claims?

Answer. The IRS wants to prevent businesses from being misled while ensuring that businesses that are making legitimate claims receive the credits they are entitled to receive. Asking taxpayers to provide books and records would require both the IRS and the taxpayer to engage in additional administrative activities that could unnecessarily burden the taxpayer. The risking methodology has allowed the IRS to identify claims with low risk of being ineligible. Since July 2024, approximately 400,000 claims, totaling about $10 billion, have been processed including both eligible claims allowed and ineligible claims not allowed, with the vast majority in this tranche being processed for approval. Checks are being mailed for eligible claims with refunds, with more planned in the weeks and months ahead. As we continue to refine our analytical tools, we will also be exploring a potential alternative treatment stream.

Question. What percentage of moratorium-delayed ERC claims are being asked to further support their claim?

Answer. We have thousands of ERC claims currently under audit.

Question. Before ending the moratorium, will the IRS execute another "soft letter" campaign highlighting repayment options, withdrawal procedures, and the possibility of ERC audits and give recipients a reasonable amount of time to respond?

Answer. No potential actions have been ruled out.

QUESTIONS SUBMITTED BY HON. MICHAEL F. BENNET

PILOT PROGRAMS

Question. The IRS has deployed machine learning tools to identify fraud trends in the Employee Retention Credit program and has used artificial intelligence (AI) to audit 76 of the largest partnerships in this country as part of the Large Partnership Compliance (LPC) program.

Is the IRS considering implementing new pilot programs that could leverage advances in machine learning and data analytics to more accurately identify tax evasion and fraud, and improve the efficiency of customer service professionals? If yes, what is your timeline for doing so, and what resources above current appropriations are required?

Answer. The question indicates that AI was used "to audit 76 of the largest partnerships. . . ." To clarify, *IRS does not use AI to conduct any audit* of a taxpayer or tax entity. The IRS *only uses AI in upstream audit planning and selection processes.*

The IRS is continuously looking at new opportunities to build and deploy the best and most advanced tools (including new and more sophisticated machine learning models) to enhance its capabilities to identify fraud and improve tax administration. The duration to develop and employ new models is usually an annual process. New or enhanced models that do not require a field test (pilot) may be deployed within a year from initiation.

Where feasible, the IRS seeks to conduct operational pilots of new AI and advanced analytics methodologies to ensure that new techniques provide an improvement over the legacy approaches they may replace without posing additional risk to the taxpayers or the IRS. The IRS is continually seeking to more accurately identify tax evasion, fraud, and noncompliance, and evaluate how we can improve our use of machine learning and data analytics to do so. We are also using AI to extract insights from data sources in the customer service domain to better understand service interactions and create new opportunities to streamline and improve the customer experience while improving the efficiency of customer service professionals. We expect process improvements to be implemented gradually over the coming years, following sufficient testing via pilot programs or other means to ensure new tools are used responsibly to produce value while protecting taxpayer rights.

Some examples of current and upcoming pilots in the near term include:

- Use of generative AI to improve plain language in taxpayer notices. The IRS is currently piloting the use of generative AI with a limited number of users

from the Office of Taxpayer Correspondence. AI is used to generate a draft. The draft is then reviewed and edited by IRS subject matter experts before it is sent to taxpayers.

- Use of natural language processing and machine learning to detect potential fraud leads in financial reporting documents. The IRS is conducting a pilot to determine whether potential fraud leads identified by an AI workflow provide an improvement over more manual legacy process.

Currently, the IRS uses a combination of employee and contractor resources to develop and support advanced analytics programs. However, with the help of IRA funding, the IRS is working to hire more data scientists who will support the development and rollout of advanced analytics pilot programs and operational uses.

DEFICIT REDUCTION AND THE TAX CODE

Question. The Bush tax cuts added $8 trillion to the debt. The 2017 Tax Cuts and Jobs Act added nearly $2 trillion more. Around a quarter of these cuts went to the top 1 percent—Americans in the bottom quintile received only 1 percent. These cuts are responsible for 57 percent of the increase in our debt-to-GDP ratio since 2001, while eroding our revenue base. Revenue as a share of GDP has fallen from about 19.5 percent in the years immediately preceding the Bush tax cuts to just 16.3 percent in the years immediately following the Trump tax cuts. Recent estimates show that making the TCJA's individual income and estate tax cuts permanent would further imperil America's public finances, costing around $350 billion a year beginning in 2027.

How can the tax code be improved to more accurately capture generational wealth transfers and contribute to sustainable debt reduction?

Answer. Treasury is the appropriate agency to answer this question.

QUESTION SUBMITTED BY HON. SHERROD BROWN

Question. Historic tax credits and historic preservation easements are effective tools to increase housing affordability in the urban core of cities in Ohio and across America—an imperative for local economies. It is essential that these credits be administered accurately and efficiently. However, I am concerned by what appears to be a very high correlation between returns involving these historic tax breaks, and audits and often litigation in Tax Court initiated by the IRS. A growing expectation by taxpayers that their legitimate use of historic tax breaks will generate costly and time-consuming litigation only serves to deter use of measures enacted by Congress to promote affordable housing.

Will you work with historic preservation stakeholders to ensure that this trend does not deter the legitimate use of historic preservation easements to convert at-risk buildings into affordable housing in places like Cleveland and Columbus?

Answer. The IRS will continue to work with taxpayers, historic building owners, nonprofits, and other stakeholders in the historic preservation community to provide clear guidance on the use of historic preservation easements and historic tax credits to benefit communities like Cleveland and Columbus. It also should be noted that there are other Federal agencies and offices that have responsibilities in this area, most notably the U.S. Department of the Interior and the Advisory Council on Historic Preservation.

QUESTIONS SUBMITTED BY HON. THOMAS R. CARPER

SOLE PROPRIETOR TAX GAP

Question. According to GAO's November 2023 report entitled "Sole Proprietor Compliance: Treasury and IRS Have Opportunities to Reduce the Tax Gap," between tax years 2014 and 2016, the IRS attributed an average of approximately $80 billion per year of the tax gap to sole proprietorships (accounting for 16 percent of the overall tax gap).

Does the IRS have an updated estimate on the sole proprietor tax gap for more recent tax years?

Answer. The most recent tax gap estimates are for 2014–2016. However, in October 2023, the IRS released Tax Gap Projections for TY 2020 and TY 2021 (Publication 5869).[9] Table 4 on page 14 of the report includes the most recent projection of the portion of the individual underreporting tax gap attributable to nonfarm sole proprietors. The TY 2021 projection is $110 billion. In contrast to our reported tax gap estimates, our tax gap projections are updated annually.

Question. How is the IRS currently monitoring the noncompliance risk of sole proprietorships?

Answer. With the National Research Program (NRP), the Discriminant Function (DIF) model, and other risk modeling, the IRS has the most well-developed and rigorous compliance risk assessment for sole proprietors relative to any other business entity type. The NRP data that are the foundation of the tax gap estimates provide extensive information on the nature and extent of sole proprietor noncompliance. DIF is a risk-based predictive model used to separate returns that have a high likelihood of a high tax change (at or above a given threshold level) from those that do not. Sole proprietor cases are a major component of the Small Business/Self Employed (SB/SE) Division's audit plans. Significant efforts and resources are also aimed at increasing sole proprietors' compliance with employment tax filing, payment, and reporting compliance.

IMPROVING SOLE PROPRIETOR TAX COMPLIANCE

Question. In addition, GAO writes: "IRS has a communications plan for platform workers, who are one type of sole proprietor. However, it does not have a coordinated communications plan focused on informing the wide variety of sole proprietors about their tax and reporting responsibilities. Such a plan would help sole proprietors meet their tax obligations and navigate tax law changes. According to stakeholders GAO spoke with, some sole proprietors are unaware of their tax obligations on income earned through online platforms. Additionally, stakeholders told GAO that they found the existing guidance overly technical and difficult to understand."

What steps is the IRS currently taking to improve the ease of tax filing for sole proprietors, particularly from a communications perspective? What is the agency's current strategy to enforce noncompliance and identify underreporting of sole proprietorships?

Answer. Our ongoing communications and engagement with small businesses, including sole proprietors, is integral to the IRS's larger focus in the strategic operating plan on improving our taxpayer service, helping taxpayers meet their tax obligations and receiving the tax incentives they deserve. The IRS offers significant resources for sole proprietors and gig workers on *irs.gov,* including detailed instructions for filing Schedule C, the Gig Economy Tax Center, Tax Tip 2023–05, tax tips for gig economy entrepreneurs and workers, and Tax Tip 2023–85, info to help gig economy workers stay on top of their tax responsibilities—to name just a few.

The IRS incorporates messaging for the many types of sole proprietors in its communications and outreach plans, engaging with regional and local small business organizations across the country on a nearly daily basis. The IRS hosted or attended more than 1,300 stakeholder partner events since July 2020. The agency also hosts a quarterly Small Business Forum with national small business organizations providing them important updates and information for their millions of members. In addition, IRS Communication and Liaison outreach team engages with small business audiences in nontax-related sole proprietor events at IRS seminars at Small Business Expos across the country, presenting plain-language tax information to these sole proprietor audiences. This outreach is expected to continue and grow through FY 2024.

The strategic operating plan, released in April 2023, discusses several initiatives for expanding enforcement in key areas and addressing the tax gap. We believe our new IRA resources will be used most effectively when focused on noncompliant high-income individuals, (including those who may be sole proprietors), large corporations; and complex partnerships that are not paying the taxes they legally owe. In addition, the strategic operating plan contains multiple initiatives that will assist all taxpayers, including sole proprietors, to meet their payment obligations by providing improved access to account information, payment reminders, easy payment options, and assistance with past-due obligations.

[9] *See* Tax Gap Projections for TY 2020 and TY 2021, Publication 5869 at *https://www.irs.gov/pub/irs-pdf/p5869.pdf.*

QUESTIONS SUBMITTED BY HON. CATHERINE CORTEZ MASTO

Question. Under the McCarran-Ferguson Act, States were tasked with regulating the business of insurance. Exercising such authority, Nevada has passed laws governing the formation, licensing, and operations of small captive insurance companies domiciled within its jurisdiction. The proposed IRS rule 109309–22 regarding small captives has caused concern among Nevada's insurance regulators and small captive industry.

Has IRS considered the impact of this regulation on State laws like Nevada's that have governed the captive insurance industry?

Answer. The McCarran-Ferguson Act provides that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically relates to the business of insurance." See 15 U.S.C. § 1012(b). In other words, McCarran-Ferguson Act precludes application of Federal law in face of State law "enacted . . . for the purpose of regulating the business of insurance," if the Federal law does not "specifically relat[e] to the business of insurance," and would "invalidate, impair, or supersede" the State law. *Humana Inc. vs. Forsyth,* 525 U.S. 299, 307, 119 S.Ct. 710 (1999).

The proposed regulations do not render ineffective any State law, nor do they displace or diminish any State regulator's ability to regulate the insurers within their jurisdiction. Rather, the proposed regulations apply concurrently with State laws. Identification of a transaction under section 6011 as an abusive or potentially abusive use of section 831(b) solely for Federal tax purposes does not in any way invalidate, impair, supersede, or otherwise affect State insurance laws.

Question. Artificial intelligence (AI) has the ability to transform customer service for the IRS. At the same time, this technology must be evaluated to protect consumers from harm. For example, a March 4, 2024 *Washington Post* article found that a private-sector AI tool gave unhelpful answers to more than 30 percent of questions asked regarding tax preparation. It did well on 529 plans and mortgage deductions, but confidently recommended an incorrect filing status and erroneously described IRS guidance on cryptocurrency.

Can you speak to how the IRS plans to use AI to more efficiently answer taxpayer questions?

Answer. As of June 20, 2024, the IRS is using two taxpayer-facing chatbots and six taxpayer-facing voicebots to provide general information to taxpayers. In addition, three taxpayer-facing authenticated voicebots provide limited account-specific information to taxpayers. These chatbots and voicebots allow taxpayers to find answers to their questions more quickly and efficiently without waiting for live assistors.

All taxpayer-facing AI tools provide content that has been predefined by IRS business owners; generative AI is not used to produce responses to taxpayers in order to ensure taxpayers do not receive inaccurate information. The only AI functionality in the chatbots and voicebots is to interpret taxpayer input (utterances) and classify those utterances as one of multiple pre-mapped request topics so the chatbot or voicebot can provide a correct, predetermined response applicable to the taxpayer's inquiry.

More specific information about the chatbots and voicebots the IRS is currently using to efficiently answer taxpayer questions is below:

- **Chatbots:** One chatbot provides general information on payment topics (*e.g.,* how to make a payment, how to set up a payment plan, how to seek financial relief or offer in compromise) while the other provides general information on topics such as refund status, advance child tax credit, identity theft, amended returns, and more.
- **FAQ-type voicebots:** The IRS is using six voicebots to provide general information to taxpayers on topics such as the economic impact payment, one-time payments, general information about notices, and the Advance Child Tax Credit. These voicebots seek to provide a more user-friendly experience for taxpayers calling the IRS than the menu-driven legacy phone systems.
- **Authenticated voicebots:** The IRS is using voicebots that leverage shared secrets such as taxpayer identification number, personal identification number, date of birth, filing status, and ZIP code to authenticate taxpayers and provide limited account-specific information such as refund status, fact of fil-

ing information, amended return status, account history, balance due, and payment plan information. These voicebots provide a more user-friendly upgrade to legacy systems.

The IRS is evaluating options to improve Customer Service Representative (CSR) capabilities through use of AI. The focus is to build an integrated information system that uses AI to understand and summarize a taxpayer question and present the CSR with contextual specific information, thereby enabling the CSRs to answer taxpayer questions effectively and with higher efficiency.

Question. How will the IRS work to ensure such technologies do not cause misinformation?

Answer. All information provided by chatbots and voicebots is predetermined by humans who are subject-matter experts; AI is not being used to generate responses to taxpayers. There is some risk that if the AI fails to correctly interpret taxpayer inquiries it will provide responses that are not applicable to the taxpayer's question, and the IRS is working to mitigate this risk by regularly reviewing the AI system to identify and reduce such occurrences. However, even responses that may not address the taxpayer's question are always predetermined by humans and will not contain information that is factually incorrect.

The IRS is conducting internal pilot projects evaluating Generative AI/Large Language Models suitability for specific uses. For some use cases the response from the model can be validated. For example, generating first draft of content that is part of a rigorous review and approval process. For all use cases under investigation, extensive tests are conducted, and a measure of accuracy is provided and used to determine fitness for the intended use case.

Question. How will IRS work to protect consumers from businesses that beta-test AI tax preparation technologies on everyday people who trust their services?

Answer. Although the IRS can't control commercial market or beta-testing services, we provide filing options to taxpayers who do not wish to use commercial products that may beta-test AI tax preparation technologies, through public-private partnerships (IRS Free File), free fillable forms, and the new Direct File program. The IRS also conducts accuracy checks when returns are filed and is implementing additional at-filing checks as outlined in the IRA strategic operating plan.

Additionally, the IRS is aware that AI can be used by bad actors to perpetuate fraud or other nefarious acts. The IRS is committed to improving our own AI-enhanced fraud detection and promoter investigation models to protect taxpayers from bad actors.

QUESTIONS SUBMITTED BY HON. MARSHA BLACKBURN

Question. I am deeply disappointed and troubled by your decision to press ahead with the agency's misguided Direct File pilot program despite significant doubts regarding the program's viability, potential costs, and the IRS's capacity to launch such a program. I am concerned that the Biden administration is repeating the same mistakes as the disastrous 2013 *healthcare.gov* rollout, which has cost taxpayers more than $21 billion.

Could you provide an update on the performance of the pilot as it relates to Tennessee, as well as a breakdown of participation by State and count of the number of participants who are Federal or State government employees?

Answer. In IRS Direct File After Action Report, we provided a breakdown of taxpayer usage by State (see footnote 2). That breakdown by State can be found in Figure 4 on page 17 of the report.

We did not collect information from taxpayers who used the Direct File pilot about whether they were Federal or State Government employees.

Over the course of the pilot, more than 3.3 million taxpayers started the Direct File Eligibility Checker, 423,450 taxpayers logged in to Direct File, and 140,803 taxpayers submitted accepted returns. More detailed information about the number of Direct File returns and acceptance rates can be found in IRS Publication 5969, IRS Direct File Pilot Program: Filing Season 2024 After Action Report, May 3, 2024, available at *https://www.irs.gov/pub/irs-pdf/p5969.pdf*.

Question. What is the approximate reject rate for returns submitted via Direct File? What was the most frequent reason for rejection? How did IRS overcome it?

How many returns received in Direct File during the pilot were flagged for potential fraud and/or sent to special processing? Of those sent to special processing, how many were rejected?

Answer. The IRS is not in the practice of releasing the requested information for any of the individual tax filing options or services taxpayers may choose to use, including Direct File, Free File, or options provided by commercial providers. However, the IRS is committed to ensuring Direct File is a secure, accurate, and easy-to-use direct e-filing system. Direct File joined the Security Summit public-private partnership and implemented all the Summit's Trusted Customer protections, leveraging insights gained over more than 2 decades of e-filing. The IRS has not identified new threats associated with Direct File or with the system's IAL2 identity verification, and the 2024 pilot's limited scope further reduced risk.

The pilot design ensured the IRS addressed the vast majority of bugs before they affected users. In the small number of cases where taxpayers did encounter rare glitches, they were quickly fixed, and additional tests were put in place to ensure that they did not recur.

Once data is available, the IRS will review the rates at which Direct File returns were amended, and the reasons taxpayers had for amending returns. In addition to the taxpayer frustration caused by needing to amend a return, amended returns are costly for the IRS to process. An analysis of amendment rates, and the reasons taxpayers filed amendments, could identify further opportunities to improve the accuracy of Direct File, including in how it guides taxpayers to recognize when they are missing information necessary to file their return.

Question. On March 12, 2024, Treasury released a statement estimating that 19 million taxpayers may be eligible to use Direct File in the 2024 filing season. What percentage of the population eligible for Direct File completed and submitted their tax return through Direct File?

Answer. Throughout this filing season, the IRS saw strong interest in Direct File from taxpayers throughout the country. Millions of people—including many from outside of the 12 pilot States—visited the Direct File website to learn about the new system. Over the course of the pilot, more than 3.3 million taxpayers started the Eligibility Checker to see if they could use Direct File; 423,450 taxpayers logged into Direct File; and 140,803 taxpayers submitted accepted returns. More detailed information about the number of Direct File return and acceptance rates can be found in IRS Publication 5969, IRS Direct File Pilot Program: Filing Season 2024 After Action Report, May 3, 2024, available at *https://www.irs.gov/pub/irs-pdf/p5969.pdf*.

Question. Over the last several months, IRS officials have given widely varying Direct File user estimates to the press. Estimates ranged from "several hundred thousand" in November 2023 to "hopes that it will reach 100,000" in March 2024. How did officials arrive at these estimates? The official launch date of the pilot never changed from mid-March, so what factors contributed to the variance in estimates?

Answer. From the beginning the IRS said that we hoped that several hundred thousand taxpayers would use Direct File during the pilot phase. When Direct File opened to the public in March, we stated that we hoped that 100,000 taxpayers would file using Direct File. More than 400,000 taxpayers logged into Direct File, and more than 140,000 filed an accepted return. Maximizing usage was never a goal of the Direct File pilot. These numbers are more than sufficient for us to evaluate Direct File.

More than 15,000 taxpayers responded to our Touchpoints survey after submitting or resubmitting their return. This is a fantastic response that provides the team with invaluable data to study to better understand the experience of Direct File. We are particularly grateful to the many taxpayers who volunteered to be contacted for follow-up user research about their experience.

Question. What was Direct File's cost per return for filing season 2024?

Two watchdog agencies, GAO and TIGTA, have found that cost estimates for the Direct File Pilot provided by IRS were not the product of best practices and could not be substantiated. Can you provide a comprehensive cost estimate that ensures all costs are included and documented?

Answer. In the Report to Congress, the IRS estimated that the annual cost for Direct File could range from between $64.3 to $248.9 million for a service that

reached between 5 to 25 million taxpayers depending on the tax scope and the taxpayers reached. We noted that these estimates were subject to uncertainty due to the nature of launching a new product like Direct File. The pilot provided an opportunity to collect concrete data on the cost of Direct File.

Through April 20, 2024, the IRS spent $24.6 million on Direct File, which includes $11.6 million in costs for the development of last year's report to Congress. Of the $13.0 million spent on pilot development and implementation, $10.6 million is technology and product development costs and $2.4 million is operational costs (customer service, cloud computing, user authentication, et cetera). To build and run the pilot, the IRS also engaged the U.S. Digital Service (USDS). The IRS's agreement with the U.S. Digital Service did not involve costs to IRS. The limited design of the pilot means that the IRS was not able to benefit from economies of scale. If the number of Direct File users were to increase, the cost per return would decrease.

$ in Millions	FY 2023	FY 2024 YTD	Total through FY 2024 YTD
FY 2023 Direct File Feasibility Study and Report to Congress	**11.6**	–	**11.6**
Technology and Product	11.6	–	11.6
Labor	0.8	–	0.8
Non-Labor	10.8	–	10.8
Advisory and assistance services	*8.6*	–	*8.6*
Equipment	*0.3*	–	*0.3*
Other goods and services from Federal sources	*1.9*	–	*1.9*
Direct File Pilot Development and Implementation	**1.5**	**11.5**	**13.0**
Customer Service	0.1	1.8	1.9
Labor	0.1	1.8	1.9
Technology and Product	1.4	9.7	11.1
Labor	0.2	2.9	3.1
Non-Labor	1.2	6.8	8.0
Advisory and assistance services	*1.2*	*3.2*	*4.4*
Ongoing cloud services	–	*0.5*	*0.5*
Equipment	–	*0.2*	*0.2*
Other goods and services from Federal sources	–	*2.8*	*2.8*
Travel and transportation of persons	–	*0.1*	*0.1*
Grand Total	**13.1**	**11.5**	**24.6**

Note: FY 2024 labor includes actuals through April 6, 2024, and an accrual through April 20, 2024. Costs do not include other shared corporate costs.

These totals include costs associated with vendor support and an interagency agreement with GSA's 18F. To build and run the pilot, the IRS also engaged 29 employees from the USDS to supplement the IRS employees and other team members. The USDS costs are not included in the $24.6 million spent on Direct File. The IRS estimates that the annualized cost for the USDS team is $7.2 million.

While the costs outlined above all center on the actual costs involved in delivering the pilot, the team is using this data to develop a more robust cost estimate for potential future costs for delivering Direct File. We look forward to working with GAO and TIGTA on those future estimates.

Question. Who decided to expand the scope of the feasibility study into Direct File? Were you, as IRS Commissioner, acting on your own authority? Did the White House, Congress, or Treasury influence the decision to go beyond the mandate in IRA?

Answer. On May 22, 2024, I issued a memo to the Secretary telling her that the IRS recommends making Direct File a permanent option for taxpayers to file their Federal tax returns beginning in 2025, and the Secretary concurred.

Question. A recent Treasury Inspector General for Tax Administration report found that more than 2,800 IRS employees are not following the mandate from Con-

gress regarding the use of TikTok, a Chinese Government spying app, on government devices. Senator Thune and I sent a letter to you this January seeking answers on Treasury's actions to comply with the No TikTok on Government Devices Act. We have yet to receive a response.

What are you doing to rectify this compliance failure? Will you commit to ensuring we receive a thorough response?

Answer. Please see my response to your letter dated May 23, 2024, which answers the questions you raised.

Question. The Treasury Department originally pledged in its May 2021 American Families Plan Tax Compliance Agenda that audits wouldn't increase for taxpayers with income below $400,000 in "actual" income relative to "recent" levels. One could assume that "actual" would be "taxable" income but instead the IRS opted for "total positive income," the sum of all available income before any deductions or exemptions, versus another measure like adjusted gross income. The goalposts have moved dramatically since then but regardless, the $400,000 figure has remained unchanged.

In May of 2021, $400,000 has the purchasing power of $344,754 as of the end of March 2024. The fact that this figure hasn't changed means there are millions more Americans, middle-class families, and small business owners that could find themselves in the crosshairs of the IRS than at the time of the original pledge. In fact, according to *The Wall Street Journal,* between 2019 and 2022 number of households with income above $400,000 increased by 3.4 million.

Has the administration changed its position on its pledge given the soaring inflation Americans have experienced since Treasury originally made this pledge?

Answer. The Secretary's 2022 directive is that audit rates will not increase over historic levels for individuals and households earning $400,000 or less. That directive has not changed.

Question. Can you clarify how this pledge applies to joint filers and commit that married couples filing jointly will be protected from the IRS's auditing dragnet?

Answer. The directive applies to households, which includes joint filers.

Question. I'd like you to address the IRS's cybersecurity deficiencies and instances that the IRS abused its access to confidential tax information, as seen in the *ProPublica* case and the recent sentencing of Charles Littlejohn, an IRS contractor who pled guilty to stealing and leaking President Trump's tax returns. Recent reports have highlighted the IRS's vulnerability to both external and internal threats, putting private taxpayers data at risk.

GAO found numerous instances of "willful unauthorized access of tax data by employees."[10] And this past fall, your agency's watchdog found that the IRS failed to maintain cybersecurity standards to the level required by Federal law.[11] These instances of negligence—and sometimes even criminal conduct—undermine the public's trust in the IRS. Law-abiding stakeholders are rightfully concerned that our tax authorities are acting in a political manner, threatening taxpayers with serious privacy breaches and punishing them for complying with the law.

Could you please provide a detailed update on how you plan to protect taxpayers' privacy and ensure that we protect taxpayers' sensitive information?

Answer. When I arrived as IRS Commissioner in March 2023, safeguarding taxpayer information was a priority for me, and I quickly focused on using new Inflation Reduction Act resources to bolster the agency's data security. In addition to reviewing the report, the IRS has taken multiple steps to improve the safeguarding of taxpayer data. These measures include:

- **Further restricting user access.** We restructured our operations to reduce the number of people with access to the most sensitive taxpayer datasets. Stronger protocols are now in place to ensure only people with documented, mission-essential needs are entitled to receive access.
- **More robust protective security controls.** We updated data protection mechanisms (*e.g.,* encryption, anonymization) to better protect taxpayer information.

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[10] *https://www.gao.gov/products/gao-22-105872.*
[11] *https://www.tigta.gov/sites/default/files/reports/2023-09/202320064fr.pdf.*

- **More frequent data entitlement reviews.** We are strengthening review protocols to ensure more IRS oversight of data users, have implemented procedures to ensure that all network access is timely removed for users who separate from the IRS, and will ensure that sensitive system access is timely removed for users who separate from the IRS. So far, we have reduced timeframes for deactivating inactive accounts assigned to current employees and contractors by 25 percent. Managers are required to review and approve initial requests for access and to periodically validate continuing user need for the access. IRS Cybersecurity will conduct additional reviews to ensure we limit access to key sensitive systems to properly authorized individuals.
- **Collection and retention of detailed access logs.** Key data sources inside the IRS have improved monitoring and event logs. We now maintain evidentiary copies of database queries and data outputs, which improves surveillance of internal data use and preserves records of who accessed which data and when. Additionally, we enforce an approved destination for data exports and prevent users from copying those files to unapproved drives and/or folders.
- **Improved firewalls.** We have added additional firewalls between key taxpayer information and the rest of the IRS, providing additional monitoring capabilities. We record all traffic between these areas to improve monitoring.
- **Stronger 24/7 monitoring.** We have expanded advanced analytics to detect and prevent risky data usage, providing improved insight into suspicious activities around the clock.
- **New tools.** We are adding new analytical tools and dashboards to monitor user activity involving sensitive data. These tools will help to improve the detection of potential data misuse.
- **Less removable media.** We have dramatically reduced users' ability to connect removable media, such as thumb drives, to IRS computers. The new protocol requires executive approval of those users who have legitimate business needs and close monitoring of user activity to watch for risky behavior. This step has significantly curtailed opportunities to remove sensitive taxpayer information from the IRS computing environment.
- **Tighter email controls.** We have dramatically strengthened email controls involving taxpayer information, including new restrictions on contractors' ability to email information outside the IRS, while preserving but closely monitoring this ability when necessary for collaborating with non-IRS employees. This step has further reduced the risk of contractors removing sensitive taxpayer information from the IRS computing environment.
- **New printer controls.** We are now logging and scanning printing by all IRS users to detect potential policy violations and to preserve evidence to support inquiries of suspected wrongdoing. This effort includes printing at telework/remote work locations.

Question. I request that you review the GAO's May 2022 report "IRS Security of Taxpayer Information: Characteristics of Employee Unauthorized Access and Disclosure Cases" (GAO–22–105872, *https://www.gao.gov/products/gao-22-105872*).

Will you commit to reviewing this report and provide a written response regarding Treasury's efforts to address the IRS's past failures to safeguard taxpayer information?

Answer. Please see my answer above on steps taken to safeguard taxpayer information.

Question. Similarly, I request that you review GAO's September 2023 report "Security of Taxpayer Information: IRS Needs to Address Critical Safeguard Weaknesses" (GAO–23–105395, *https://www.gao.gov/products/gao-23-105395*).

Will you commit to reviewing this report and provide a written response addressing the GAO's recommendations to the IRS, and what steps you have taken to implement GAO's outstanding recommendations?

Answer. Please see my answer above on steps taken to safeguard taxpayer information. In addition, I can note that we have taken multiple steps so far to address weaknesses that were identified in the report. We have centralized the responsibility for monitoring contractor training completion and established a 90-percent

training completion goal for contractors, and we are monitoring the training completion rates for contractors and sharing completion rates with appropriate personnel.

In addition, we have developed a reference guide to assist contracting officer representatives (COR) with documenting and reporting Unauthorized Access to Tax Return Information (UNAX) and unauthorized disclosure incidents involving contractors; and improved the consistency and reliability of contractor UNAX reporting, and with improved reporting, we are able to monitor UNAX and unauthorized disclosure cases for trends and take appropriate action when trends are identified.

Question. I would appreciate an expedient response regarding the substantiation and disclosure requirements for charitable contributions.[12] I have heard from Tennesseans that have had their charitable contribution deductions retroactively denied due to the arcane documentation rules. I am concerned that the strict "contemporaneous" requirements have prevented philanthropic contributions from being acknowledged by the agency and will have a chilling effect on charitable contributions. These organizations are integral to local communities and families in Tennessee.

In cases where taxpayers have made charitable contributions in good faith but are subsequently denied deductions due to minor technical errors in the contemporaneous acknowledgment provided by the recipient charitable organization, would the IRS consider implementing a policy that allows these taxpayers a grace period to correct such acknowledgments?

Answer. The contemporaneous written acknowledgement (CWA) rules were established by Congress under the IRC. Under section 170(f)(8)(A), enacted in 1993, a taxpayer may not take a deduction for a charitable contribution of $250 or more unless the taxpayer substantiates the contribution with a CWA of the contribution by the donee organization. Section 170(f)(8)(C) specifies that an acknowledgement will be considered "contemporaneous" if the taxpayer obtains it on or before the earlier of (i) the date on which the taxpayer files a return for the taxable year in which the contribution was made, or (ii) the due date for filing such return.

In section 170(f)(17), Congress has imposed additional recordkeeping requirement for contributions in the form of cash, check, or other monetary gift. Regardless of the amount, no deduction is allowed for any such contribution unless the donor maintains a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution.

Congress enacted the CWA requirements to increase compliance with rules governing charitable contributions. By requiring taxpayers to obtain a CWA, Congress aimed to ensure that taxpayers were aware of potential limitations to the deductibility of certain contributions, such as in situations involving a quid pro quo. S. Prt. No. 103–37 at 91 (1993).

In section 170(f)(8)(D), Congress has authorized Treasury and IRS to implement rules to ease burden on small donors. Under that authority, Treasury and IRS issued regulations that except small contributions of less than $250 from the CWA requirements. This exception applies even when the taxpayer's total contributions to the same charity in the same year equal or exceed $250. See Treas. Reg. § 1.170A–13(f)(1).

Question. This exemption could provide a fair opportunity to address and rectify these minor discrepancies without penalizing well-intentioned donors. In the 2024 Taxpayer Advocate Service (TAS) Purple Book, TAS proposed a legislative change to loosen strict contemporaneous timing requirements (Recommendation #59, *https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2024/01/ARC23_PurpleBook_08_MiscRecs_59.pdf*). TAS argues that current requirements harm taxpayers and tax-exempt organizations that make a technical mistake in their written acknowledgment or that provide some necessary information only after the statutory deadline has passed.

Could you elaborate on the IRS's position on this specific TAS recommendation, and will you commit to working with my office on potential legislation on the issue?

Answer. As you stated, the National Taxpayer Advocate 2024 Purple Book includes a TAS proposal for a legislative change to remove the requirement that written receipts acknowledging charitable contributions must be contemporaneous (Recommendation #59), which states:

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[12] *https://www.irs.gov/pub/irs-pdf/p1771.pdf.*

> To claim a charitable contribution, a taxpayer must receive a written acknowledgement from the donee organization before filing a tax return. For example, if a taxpayer contributes $5,000 to a church, synagogue, or mosque, files a tax return claiming the deduction on February 1st, and receives a written acknowledgement on February 2nd, the deduction is not allowable—even if the taxpayer has credit card receipts and other documentation that fully and unambiguously substantiate the deduction. This requirement can harm civic-minded taxpayers who do not realize how strict the timing requirements are and undermines congressional policy to encourage charitable giving. We recommend Congress modify the substantiation rules to require reliable—but not necessarily advance—acknowledgement from the donee organization.

The "contemporaneous" timing component of section 170(f)(8) is a longstanding statutory requirement that has been in effect since 1993. The statutory language provides clear guidance on what "contemporaneous" means for the CWA requirements. Charities are well-versed in these requirements, and the timing component is well understood and not complex. Many tax preparation software providers integrate pop-up reminders about the CWA requirement when a contribution amount is input. Additionally, the related IRS publications and the instructions for forms where a taxpayer would claim a deduction under section 170 provide numerous alerts to these CWA requirements. See *e.g.,* Publication 526, Charitable Contributions; and the Instructions for Schedule A (Form 1040).

We believe that this longstanding and clear definition of "contemporaneous" enables ease in compliance and administration. If the CWA is not required to be contemporaneous, the effect of the CWA is diluted and could make it less meaningful.

We are concerned that the removal of the timing component may create a greater burden for both the donee and the donor in the event of an examination in subsequent years.

If Congress determines to replace the CWA requirement with new standards for the section 170 substantiation requirements, it must consider the historic concerns that led to the adoption of today's current standards. These concerns include widespread abuse of section 170 deductions, clear standards for substantiation, and concerns of administrability. Legislating clear standards for substantiation is also essential to ensure compliance and reduce the likelihood of confusion or abuse.

Treasury may be better suited to working on legislation and addressing any policy considerations. However, the IRS will serve to assist Congress and Treasury work on legislation and to implement and uphold whatever legislation Congress passes.

QUESTIONS SUBMITTED BY HON. BILL CASSIDY

Question. According to an article in *Forbes,* the IRS Direct File program contains Google Analytics JavaScript code and a more covert tracking mechanism called canvas fingerprinting. As I understand it, these tools potentially offer valuable insights into user behavior, which can be leveraged to enhance functionality, improve user support, and even discern what outreach campaigns are most effective.

Is the IRS partnering with any other companies to collect, aggregate, or otherwise use taxpayer information?

Answer. The IRS is committed to protecting the privacy and security of taxpayers and their personal information. IRS did not track individual taxpayers' usage of Direct File. Direct File uses Google Analytics for collecting anonymous data in the aggregate that can be used to identify improvements to the Direct File product; *use of Google Analytics does not involve the collection of any personally identifiable information.* As part of Direct File, taxpayers who used customer support or successfully filed a tax return were given the ability to take an optional customer survey to provide feedback on their experience. The IRS is not partnering with any other companies to collect, aggregate or otherwise use taxpayer information. The optional customer survey conducted was done by the IRS using the General Services Administration's survey tool.

Question. If so, what is the scope of taxpayer information being collected, and for what uses?

Answer. As noted above, the IRS is not partnering with companies to collect, aggregate, or otherwise use taxpayer information. The IRS administered the optional customer survey.

Question. As part of the agency's increased focus on the tax issues applicable to partnerships and partners, the IRS says that it has been increasing compliance to ensure that Self-Employment Contributions Act (SECA) taxes are being properly reported and paid by wealthy individual partners who provide services and have inappropriately claimed to qualify as "limited partners" in State law limited partnerships (such as investment partnerships) not subject to SECA tax. In contrast to wage earners whose employment taxes (Federal Insurance Contributions Act/FICA) are deducted from their paychecks, self-employed individuals are required to report and pay their SECA taxes on their Federal income returns.

In November 2023, the U.S. Tax Court issued an opinion in *Soroban Capital Partners LP vs. Commissioner* that agreed with the IRS's position that the limited partner exception to SECA tax does not apply to a partner who is "limited" in name only. As a result, partners who actively participated in the State law limited partnership must report their partnership share as net earnings from self-employment subject to SECA tax.

Given the dire circumstances of Social Security and Medicare, I am more sympathetic with enforcement mechanisms that help shore up solvency for these programs.

In addition to your focus on large partnerships, are you integrating AI systems to detect payroll and self-employment tax avoidance?

Answer. The IRS is actively working to develop and improve its models for selecting cases for examination, including partnerships. The examination of a partnership may include assessing if a limited partner was subject to SECA and did not correctly pay the tax.

Question. What are some indications in addition to the potential mischaracterization of a "limited partner" that payroll or self-employment tax is being avoided imprudently?

Answer. In addition to the "limited partner" exception, taxpayers try other approaches to inappropriately argue that they do not owe self-employment taxes. Some taxpayers create complicated organizational structures using various pass-through entities (partnerships and S corporations) to try to optimize inconsistencies in the application of the SECA tax and the net investment income tax. This is the subject of a proposal in Treasury's 2025 Green Book. Other taxpayers enter a partnership with one or more nonworking family members (for example, a spouse). These taxpayers argue that income allocated from the business to the family members is passive, and therefore not subject to SECA, even though in reality the income is generated by the taxpayer and includable on that individual's return as business income subject to SECA. Still others may wrongly claim that income is not income derived from a trade or business carried on by the individual, but instead earned through other means that are not subject to SECA. Some employers attempt to avoid payroll tax obligations by misclassifying common law employees as independent contractors or pay wages to an entity, instead of directly to an employee.

Question. It feels like we started to make some initial progress toward clearer guidance for the historic preservation community, building owners, and taxpayers, on how to use historic preservation easements to help save buildings in New Orleans and across the country. However, we still have work to do. We would appreciate it if you will urge your team at the IRS to work in earnest with my staff and others from this committee, as well as with stakeholders in the historic preservation community, to continue to work on solutions.

Will you please work with Chief Counsel Marjorie Rollinson on a strategy to finalize clearer regulatory guidance for historic preservation easements going forward?

Answer. The IRS looks forward to working with Chief Counsel Rollinson to develop regulatory guidance for historic preservation easements. Similarly, we look forward to working with committee staff, historic building owners, nonprofits, and other stakeholders in the historic preservation community. It also should be noted that there are other Federal agencies and offices that have responsibilities in this area, most notably the U.S. Department of the Interior and the Advisory Council on Historic Preservation.

QUESTIONS SUBMITTED BY HON. JOHN CORNYN

Question. Despite the best efforts of regulators and law enforcement, unscrupulous individuals continue to defraud investors and consumers through Ponzi schemes and other fraudulent enterprises. When these illicit operations collapse, a Federal receiver is typically appointed to recover and distribute any remaining assets to the victimized parties.

I have been told that the distribution process often encounters unnecessary delays due to the Internal Revenue Service's (IRS) procedures. Before the Federal receiver can disburse funds, they must obtain a final determination from the IRS regarding the tax liabilities of the fraudulent enterprise. This determination process can, and frequently does, take up to 3 years or more to complete. Moreover, by statute, the Federal receiver faces personal liability for unpaid taxes if reserves for such taxes are insufficient after distributions are made to victims. In certain cases, a receiver has been required to claw back distributions to satisfy the tax obligation.

Considering the financial hardship endured by the victims of these fraudulent schemes, what measures is the IRS taking to expedite these determinations and ensure the timely distribution of recovered assets? As you may know, the bankruptcy process incorporates statutory mechanisms (11 U.S.C. 505) to facilitate prompt tax liability assessments, in some cases as quickly as within 60 days after the request for a determination is made.

Answer. The IRS is committed to ensuring that it doesn't unnecessarily delay the distribution of assets in receivership proceedings. For example, on December 1, 2022, the IRS updated IRM 5.9.20 (April 3, 2017), Non-Bankruptcy Insolvencies (including receiverships) to ensure that IRS employees apply the procedures applicable to all non-bankruptcy insolvencies, including receiverships, uniformly (and we endeavor to process these quickly). In addition, we work closely with the receivers and our Chief Counsel and Department of Justice attorneys to facilitate distributions to the victims of fraudulent schemes. For example, in Ponzi schemes, when the funds to be distributed to victims are traceable to the fraudulent scheme, the United States typically won't assert an interest in the funds and may stipulate to the distribution(s). Also, when a receiver is requesting a decision on whether the IRS will audit a return, in light of their concern for personal liability under 31 U.S.C. § 3713 (Federal insolvency statute), those decisions are prioritized.

Question. What explains the IRS's apparent failure to timely provide Federal receivers with the necessary determination?

Answer. Each receivership is different, and the IRS must balance the need for timely distribution with protection of governmental interests in accordance with Federal law, including 31 U.S.C. § 3713, governing priority of government claims. It would be helpful to have specific examples of when the IRS purportedly failed to provide timely determinations in receivership cases to better understand where delays may be happening and how to address them.

Question. Will you and the IRS commit to provide Federal receivers with the necessary and timely service that will help them to appropriately distribute recovered assets to those victimized by fraudsters?

Answer. Yes. Also, to the extent there is a private-sector receivership group, we sometimes face delays from the receiver's delay, but we are committed to improving the process and working to expedite these requests.

Question. In December 2023, you provided information to this committee in response to a question I submitted during last year's tax season hearing, confirming that more than 1,100 small captive audit cases are pending in the U.S. Tax Court—a case load that could take decades to resolve. As you may know, since 2017 the IRS has allowed just seven cases to go to judgment, leaving the remaining taxpayers in limbo for years. You also reported that the IRS has settled approximately 27 percent of the section 831(b) cases that previously were before the U.S. Tax Court for 10 percent or less than the claimed deficiency, including penalties. Many small business taxpayers have incurred significant costs and spent years fighting what appears to be overstated tax assessments.

To better understand the challenges facing taxpayers, please provide the following information regarding section 831(b) cases that have been pending for 1 year or more:

The number of cases where the IRS asked for two or more continuances, but the taxpayer has not asked for one.

Answer. As we explained in our previous responses to the Senate Finance Committee in April 2023, each small captive audit may result in multiple related cases docketed in the Tax Court that we refer to as a "family." Upon motion by the parties or upon its own motion, the Tax Court typically orders consolidation of a family of all related dockets. The family is consolidated for trial, briefing, and opinion pursuant to Tax Court Rule 141. The IRS has asked for two or more continuances where the taxpayer has not asked for one in only three families, which involve eight dockets. While the taxpayers did not request the continuances sought by the IRS in those three case families, the taxpayers also did not oppose the continuances sought by the IRS. Generally, we only seek continuances when we need more time to hire experts, complete discovery, file dispositive motions, or prepare our cases for trial. Moreover, the Court will not likely grant a continuance if the taxpayers object in good faith, or if the party seeking the continuance has not stated a sufficient basis for it. A continuance may be granted over an objection if the Court does not have the time to try the case on that calendar, but in such a situation, the Court retains jurisdiction over the case and schedules it on a special trial calendar.

Question. The number of cases where the IRS asked for three or more continuances than the taxpayer has (including the cases identified above).

Answer. The IRS asked for three or more continuances than the taxpayer in three families, which involve eight dockets. Two of the families responsive to this request are also included in the families mentioned above. Again, the taxpayers did not oppose the continuances sought by the IRS in the three case families responsive to this request.

Question. A list of all cases where the deficiencies attributable to the captive have been settled for 10 percent or less and where the IRS asked for two or more continuances.

Answer. The IRS interprets this request to include only those cases in which it unilaterally requested two or more continuances, and it is not including joint motions for continuance in its response to this request. Only four cases fall into this category. See our previous responses to Senate Finance Committee, Senator Cornyn (July 2023) and Ways and Means Committee, Representative Feenstra (March 2024).

Question. A report analyzing the IRS's continuance practices with respect to cases involving microcaptives that elaborates on this data and answers the question of whether or not there have been (or will be) instances where the IRS continued cases that it should have otherwise been settled.

Answer. Counsel is dedicated to the timely and fair resolution of all taxpayers' cases in the Tax Court. Counsel strives to ensure that all taxpayers are treated equally, and that the correct amount owed is determined. Counsel evaluates every case separately, regardless of the type or size of the case. Counsel does not have a "practice" regarding continuances in microcaptive cases, but counsel attorneys are instructed to request them sparingly. See CCDM 35.3.4.2 (August 11, 2004), Continuances From Trial Date. Counsel's goal is to resolve every case as quickly, efficiently, and fairly as possible. Moreover, Tax Court Rule 133 provides in relevant part: "Continuances will be granted only in exceptional circumstances." The parties' joint requests and counsel's unilateral requests for continuance met the Tax Court's criteria.

In general, when a case is petitioned, the Commissioner then has 60 days to file his answer. Once a case is answered the parties generally must wait at least 30 days before they can commence discovery or take other actions. If a taxpayer has not previously had an opportunity to be heard by the IRS Independent Office of Appeals, counsel sends the case to the Independent Office of Appeals for consideration, unless the taxpayer specifically requests that the case not be considered by that office.

The Tax Court will usually "calendar" a case for trial in the location requested by the petitioner no sooner than 4 months after the case is answered. Some cities have fewer trial calendars than others, so the timing for a case to be calendared can vary significantly, based on the date of the Tax Court's next trial session in a city. The Tax Court frequently calendars cases while they are still being considered by the Independent Office of Appeals and before the parties have engaged in discovery. Accordingly, the parties may jointly request that the Tax Court continue the case to allow for the appeals process to continue and potentially yield a result acceptable to the parties, such that a trial is no longer necessary. Many times, the Tax Court judge who rules on that initial joint motion for continuance will retain

jurisdiction over that case and require the parties to file a joint status report in 90–120 days to inform the Tax Court of the status of the case at that point in time (subsequent status reports are frequently ordered—these are not continuances of a trial). If resolution is not reached through the appeals process, the assigned judge determines the trial schedule for that case based on a number of factors, such as the discovery still required to be completed, the availability of the courtroom in the requested place of trial, the parties' availability, and the judge's schedule. Other times, a case will be returned to the "general docket," in which case, unless the parties reach settlement, the case will again be placed on the next available trial calendar for the city requested by the taxpayer, but again generally no sooner than 4 months from the date of the notice setting the case for trial.

Trials for microcaptive insurance cases frequently take multiple weeks to complete and are generally not suitable to be tried during the Tax Court's regular trial sessions. Accordingly, they are often set for "special trial sessions" of the Court—this requires the parties to request a continuance off of the regular trial calendar, to a date certain.

While Counsel or taxpayers may seek to continue certain microcaptive cases when warranted, the cases are continued only by order of the Tax Court. Of all currently pending microcaptive cases petitioned in the Tax Court prior to May 29, 2023, and ordered to be continued by the Court, the taxpayer requested the continuances jointly with counsel 89.5 percent of the time. Even in the 10.5 percent of those cases where the taxpayer did not jointly request the continuances with counsel, the taxpayer objected to counsel's motions for continuance only 13 times.

Question. I also continue to hear concerns from my constituents about the IRS's default position that taxpayers who use section 831(b) are guilty of tax avoidance or tax evasion unless and until they prove otherwise. Some even suggest that IRS agents lack the knowledge to regulate captive insurance, and others say that the IRS lacks the expertise to administer insurance. How would you respond to these concerns?

Answer. The IRS takes seriously the proper enforcement of the tax laws, including those governing captive insurance. Taxpayers should pay taxes legally due, no more and no less. To ensure that taxpayers pay the amount of tax legally due, the IRS must stop abusive transactions that give rise to improper tax treatment. Microcaptive cases selected for audit meet the criteria for transactions that have characteristics of a tax plan. After the examination is commenced, the IRS requests information from the taxpayer to support the taxpayer's position on the tax return it filed with the IRS. The IRS analyzes and evaluates the information provided by the taxpayer. In the case of microcaptives, the IRS generally evaluates whether the premiums deducted are properly deductible as ordinary and necessary business expenses and whether the transaction is insurance for Federal income tax purposes.[13] The IRS does not regulate captive insurance or administer insurance. However, the IRS does evaluate whether taxpayers have documentation to support positions taken on their returns.

The IRS on multiple occasions encouraged taxpayers that may be involved in abusive microcaptive insurance transactions to consult independent tax advisors regarding their filing positions and consider exiting these transactions by not claiming deductions or by filing amended returns to reverse claims to improper deductions.

Question. As you know, on December 22, 2022 the IRS announced in Notice 2023–10 a delay in the reporting threshold for third-party settlement organizations that was set to take effect for the 2022 tax filing season. Because of this delay, third-party settlement organizations were not be required to report the tax year 2022 transactions on a Form 1099–K to the IRS as enacted and required by section 9674 of Pub. L. 117–2:

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[13] In all of the microcaptive cases decided on their merits, the Tax Court has concluded that the microcaptive transaction at issue lacked the necessary characteristics, based on the specific facts in each case, to qualify as insurance for Federal tax purposes. *See Avrahami vs. Commissioner,* 149 T.C. 144 (2017); *Syzygy vs. Commissioner,* T.C. Memo. 2019–34; *Caylor vs. Commissioner,* T.C. Memo. 2021–30; *Keating vs. Commissioner,* T.C. Memo. 2024–2; *Swift vs. Commissioner,* T.C. Memo. 2024–13; *Patel vs. Commissioner,* T.C. Memo 2024–34; and *Royalty Mgmt. Ins. Co., Ltd. vs. Commissioner,* T.C. Memo. 2024–87; *see also Reserve Mechanical Corp. vs. Commissioner,* 34 F.4th 881 (10th Cir. 2022) (concluding transactions entered into by company filing as a tax-exempt entity under section 501(c)(15) did not meet the requirements for treatment as insurance for Federal income tax purposes).

SEC. 9674. MODIFICATION OF EXCEPTIONS FOR REPORTING OF THIRD PARTY NETWORK TRANSACTIONS.

(a) IN GENERAL.—Section 6050W(e) of the Internal Revenue Code of 1986 is amended to read as follows:

"(e) DE MINIMIS EXCEPTION FOR THIRD PARTY SETTLEMENT ORGANIZATIONS.—A third party settlement organization shall not be required to report any information under subsection (a) with respect to third party network transactions of any participating payee if the amount which would otherwise be reported under subsection (a)(2) with respect to such transactions does not exceed $600.".

(b) CLARIFICATION THAT REPORTING IS NOT REQUIRED ON TRANSACTIONS WHICH ARE NOT FOR GOODS OR SERVICES.—Section 6050W(c)(3) of such Code is amended by inserting "described in subsection (d)(3)(A)(iii)" after "any transaction".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to returns for calendar years beginning after December 31, 2021.

(2) CLARIFICATION.—The amendment made by subsection (b) shall apply to transactions after the date of the enactment of this Act.

The Joint Committee on Taxation, which serves as a nonpartisan tax policy and revenue estimating resource to Congress, scored section 9674 as raising $145 million in 2022, $1.081 billion in 2023, and $8.403 billion from 2022–2031 [JCX–14–21]. Hence, it appears JCT believed that the IRS would enforce section 9674 per the effective date. I oppose this intrusive and burdensome proposal and am a cosponsor of the SNOOP Act, which eliminates this reporting requirement.

During your confirmation process in February 2023, I asked you to explain what the legal basis was for the delay and if you thought the IRS had the legal authority to make this decision without congressional action. Your response was:

> The American Rescue Plan included a provision to require third-party settlement organizations to report certain transactions to the IRS. It was set to take effect this year. It's my understanding the IRS recently announced a 1-year delay. I am not familiar with the specifics surrounding this decision and therefore, cannot speak to the legal or regulatory authorities that served as the basis for this delay. If confirmed, I look forward to learning about this issued delay and updating you and your staff.

In November 2023, the IRS announced another 1-year delay in the enforcement of section 9674.

Please explain the specifics surrounding the decision to delay the enforcement of section 9674 for the second time.

Answer. Section 7803(a)(2)(A) gives the IRS Commissioner discretion to administer the tax law, which includes the discretion to enforce or not enforce penalty provisions. Section 7803(a)(2)(A) gives the Commissioner broad discretion to "administer, manage, conduct, direct, and supervise the execution and application of the Internal Revenue laws." We have delayed implementation of laws in the past in the interests of tax administration. For example, we delayed implementation of the employer shared responsibility provision under section 4980H for 1 year. This was done to give the public and the IRS time to develop their systems and processes for the new provision. Likewise, we delayed the companion information reporting provision under section 6056. We also provided penalty relief for several years under sections 6055 and 6056 for the time to file if filers could demonstrate good faith efforts to file accurately. Additionally, the IRS delayed withholding under the Foreign Account Tax Compliance Act (FATCA) and certain other FATCA timelines.

For reporting on Form 1099–K, we have worked closely with stakeholders and believe we now have the right path given this law's novel complexities.

As the IRS continued to work to implement the new law, the agency determined that it would treat 2023 as an additional transition year to reduce the potential confusion caused by the distribution of an estimated 44 million Forms 1099–K that would be sent to taxpayers who may not expect one and may not have a tax obligation. Given the confusion taxpayers may experience when getting a Form 1099–K where they may not have income, the large number of individual taxpayers affected and the need for stakeholders to have certainty with enough lead time, the IRS determined it would be in the best interest of tax administration to delay enforcement of the new law for one additional year. The IRS will use this additional time to continue carefully charting an implementation path that simplifies the process and

minimizes undue burden on taxpayers. Our intention has always been—and will always be—to implement the law as Congress enacted.

Question. Please explain the legal or regulatory authorities that serve as the basis for the delay of enforcing section 9674 for the second time.

Answer. Section 7803(a)(2)(A) gives the IRS Commissioner broad discretion to administer the tax law. We have delayed implementation of complex laws in the past in the interests of tax administration. Section 7803(a)(2)(A) gives the Commissioner broad discretion to "administer, manage, conduct, direct, and supervise the execution and application of the Internal Revenue laws." This includes the discretion to enforce or not enforce penalty provisions (*i.e.,* sections 6721 and 6722).

Question. Does Section 7803(a)(3), which was enacted as part of the FY 2016 Consolidated Appropriations Act (Pub. L. 114–113, title IV, subtitle A, section 401), provide the IRS with this authority? If so, how many times has the IRS evoked section 7803(a)(3) when administering the Internal Revenue Code? Please list each time.

Answer. No, section 7803(a)(3) requires the Commissioner, in discharging his duties, to "ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title. . . ." Rather, section 7803(a)(2)(A) provides the Commissioner with the authority to delay implementation.

Question. "Yes" or "no," do you believe the IRS has the legal or regulatory authority to delay the enforcement of section 9474 for another year? Why or why not?

Answer. See response to question below.

Question. "Yes" or "no," do you believe the IRS has the legal or regulatory authority to delay the enforcement of section 9474 for another 5 years? Why or why not?

Answer. See response to question below.

Question. "Yes" or "no," do you believe the IRS has the legal or regulatory authority to delay the enforcement of section 9474 indefinitely? Why or why not?

Answer. Section 7803(a)(2)(A) gives the Commissioner broad discretion to "administer, manage, conduct, direct, and supervise the execution and application of the internal revenue laws." This includes the discretion to enforce or not enforce penalty provisions (*i.e.,* sections 6721 and 6722) and the ability to efficiently and effectively implement new laws and changes to laws." The IRS has used this authority to delay implementation of expanded Form 1099–K reporting as part of a phased implementation of the law.

QUESTIONS SUBMITTED BY HON. STEVE DAINES

Question. Last Congress, a version of my Conservation Easement Program Integrity Act to shut down abusive conservation easement transactions was signed into law.

How has my bill helped the IRS crack down on abusive transactions, and to date how much does the IRS project my bill has saved the taxpayers?

Answer. I very much appreciate Congress taking action to pass legislation that addresses abusive syndicated conservation easements. For several years, the IRS has been taking various actions to address these transactions. The legislation was needed in the wake of the Finance Committee report of August 25, 2020, which found, among other things, that the conservation easement transactions examined were exceptionally abusive. The report found that the transactions examined were nothing more than retail tax shelters which allowed taxpayers to buy tax deductions with no economic risk. These abusive transactions undermine the public's trust in private land conservation and defraud the government of revenue. The IRS recognizes the important role of legitimate conservation easement deductions in incentivizing land preservation for future generations. The IRS is committed to continuing to administer the IRC in a way that encourages conservation easements while curbing the abuse that has overshadowed the true purpose of the law.[14]

[14] In recent Tax Court cases, the IRS has prevailed in establishing that these cases involve grossly inflated valuations. *See, e.g., Oconee Landing Property vs. Commissioner,* T.C. Memo 2024–25 ($20.7 million valuation claimed, reduced to zero due to a lack of a qualified appraisal, and the 40-percent gross valuation misstatement penalty); *Savannah Shoals, LLC vs. Commis-*

Section 170(h), which became law as section 605 of the SECURE 2.0 Act, provides the IRS with new and powerful tools for ensuring the legitimate use of conservation easements and historic preservation easements. The legislation enabled us to issue guidance to taxpayers, such as Notice 2023–30 (Safe Harbor Deed Language for Extinguishment and Boundary Line Adjustment Clauses), updated forms and publications to better address conservation easements, and proposed and final regulations (88 Fed. Reg. 80910 and 89 Fed. Reg. 54284) to implement section 605.

We are hopeful the legislation has and will curb these abusive transactions. We expect taxpayers are less likely to enter these abusive transactions and we are hopeful they will not find ways to circumvent the law. Taxpayers just completed filing of 2023 tax returns, which is the first full year that the legislation was in effect, and complete filing data is not currently available. Therefore, we cannot yet project how much the bill has saved taxpayers. For tax years 2016–2022, syndicated easements of open space, facades and similar transactions accounted for almost $6.2 billion in deductions per year, of which approximately $5 billion was open space easements. Anecdotally, we have seen some shifts to transactions structured similarly to SCE but with different property, continued fee simple donations, and promotional material developed to circumvent the 2.5 times basis limitations but are unable to quantify the impact at this time. We continue to address transactions that were entered into prior to the passage of the bill.

Question. At the time of the hearing, reports were as few as 100,000 taxpayers used Direct File this season, and that the IRS spent $127 million this year on the program. With these numbers, each return for this small subset of taxpayers cost the average Montanan $1,270 to file other peoples' taxes.

Now that filing season has ended, what was the total number of Direct File users?

Answer. Over the course of the pilot, more than 3.3 million taxpayers started the Direct File Eligibility Checker, 423,450 taxpayers logged in to Direct File, and 140,803 taxpayers submitted accepted returns. More detailed information about the number of Direct File return and acceptance rates can be found in IRS Publication 5969, IRS Direct File Pilot Program: Filing Season 2024 After Action Report, May 3, 2024, available at *https://www.irs.gov/pub/irs-pdf/p5969.pdf*.

This data alone does not suggest the total extent of taxpayer interest in Direct File. Direct File was unavailable to the general public early in filing season when many taxpayers file to receive much needed tax refunds and was later only available in 12 pilot States. The 2024 Taxpayer Experience Survey will again include questions about Direct File, potentially revealing more about taxpayers' updated level of interest with the benefit of the pilot and associated media coverage.

What the data does show is that whatever the theoretical maximum level of interest is, it has not yet been reached. Each week following the announcement of Direct File's availability, growth in Direct File usage far outpaced overall filing season trends, reflecting significant upside potential, as shown in Figure 3. The data demonstrates taxpayer demand for a Direct File option. Further study can quantify the extent of that demand.

In the report to Congress, the IRS estimated that the annual cost for Direct File could range from between $64.3 to $248.9 million for a service that reached between 5 to 25 million taxpayers depending on the tax scope and the taxpayers reached. We noted that these estimates were subject to uncertainty due to the nature of launching a new product like Direct File. The pilot provided an opportunity to collect concrete data on the cost of Direct File.

Through April 20, 2024, the IRS spent $24.6 million on Direct File, which includes $11.6 million in costs for the development of last year's report to Congress. Of the $13.0 million spent on pilot development and implementation, $10.6 million is technology and product development costs and $2.4 million is operational costs (customer service, cloud computing, user authentication, et cetera). The limited design of the pilot means that the IRS was not able to benefit from economies of scale. If the number of Direct File users were to increase, the cost per return would decrease. Both GSA (through 18F) and USDS supported the IRS in our work to deliver the Direct File and were essential to the successful delivery of the pilot. While the cost of USDS was born by the Office of Management and Budget (OMB), the IRS entered into an Interagency Agreement (IAA) with GSA to cover the cost of the 18F support. As noted in the IRS Direct File Pilot Program Filing Season 2024 After Ac-

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sioner, T.C. Memo. 2024–35 ($23 million charitable deduction reduced to $480,000 with a 40-percent gross valuation misstatement penalty).

tion Report dated May 3, 2024, Publication 5969 (Direct File After Action Report),[15] the IRS estimates that the annualized cost for the USDS team is approximately $7.2 million.

QUESTIONS SUBMITTED BY HON. CHUCK GRASSLEY

Question. President Biden and Secretary Yellen have repeatedly promised not to use mandatory IRS funding to increase audits on those earning under $400,000. However, a recent *Wall Street Journal* editorial notes that as of last summer, more than 60 percent of new audits targeted taxpayers with income under $200,000. And a recent TIGTA report notes that IRS is still "continuing to develop their proposal to comply with the Secretary's mandate."

What is taking the IRS so long to develop a proposal to comply with the Secretary's pledge not to increase audits on taxpayers earning under $400,000? Clearly, the promise to not target middle-income taxpayers has been broken by the Biden administration.

Answer. The Commissioner has publicly committed that the IRS will comply with the Secretary's directive to not increase audit rates above historic levels for small businesses or household earning less than $400,000. We have already announced that Tax Year 2018 will be the historical level. Total Positive Income (TPI) will be the measure of income for individuals, and Tax Year 2023 will be the first year that the directive applies to not increase audit rates for small businesses or households earning less than $400,000 above Tax Year 2018 historic levels. Examinations of Tax Year 2023 tax returns filed in 2024 will begin as FY 2024 concludes and FY 2025 starts, with a larger share of the examinations beginning later in FY 2025. IRS will continue working with the Treasury Department to reach an agreement on the methodology for the examinations of Tax Year 2023 returns.

We respectfully submit that the Service's commitment to administering the tax code in accordance with this directive is reflected in the enforcement efforts we have undertaken since implementation of the IRA in 2022. Specifically, we note the steps the IRS has taken to shift more tax compliance attention to noncompliant high-income earners, partnerships, large corporations, and abusive promoters.

Question. Shouldn't the IRS pause or scale back enforcement activity using its mandatory funding until it is able to follow-through with the Secretary's supposed mandate to only target the upper-income?

Answer. The IRS is using the enforcement funding provided by the IRA to hire accountants, engineers, economists, data scientists, attorneys, and tax experts with the specialized skills to examine the complex returns of large corporations, complex partnerships, and noncompliant high-income individuals.

Question. When Democrats authorized billions in mandatory funding, they chose to allocate the bulk of such funds to enforcement. This decision has created a funding cliff for taxpayer services and business systems modernization beginning in Fiscal Year 2025.

Despite this coming cliff, the IRS is siphoning millions of dollars from its business systems modernization account to fund its Direct File initiative. Of course, every dollar spent on Direct File is one less dollar available to make critical improvements to its business systems to better protect taxpayer information and guard against security threats.

Given the high importance of modernizing its business systems, does it make sense for the IRS to divert scarce resources from critical needs to what some view as an unnecessary political pet project?

Answer. The IRS was able to fund the Direct File program pilot with minimal impact to IRS program areas. This was largely due to the targeted filling options and narrow system scoping of the system infrastructure. IRS spent $24.6 million on Direct File, from the beginning of the pilot through April 20, 2024. The $24.6 million includes all vendor and interagency costs, including $2.8 million obligated through April 20th for GSA support. Both GSA (through 18F) and USDS supported the IRS in our work to deliver the Direct File and were essential to the successful delivery of the pilot. While the cost of USDS was born by the Office of Management and

[15] *See* IRS Direct File Pilot Program Filing Season 2024 After Action Report dated May 3, 2024, Publication 5969, *https://www.irs.gov/pub/irs-pdf/p5969.pdf*.

Budget (OMB), the IRS entered into an Interagency Agreement (IAA) with GSA to cover the cost of the 18F support. As noted in the IRS Direct File Pilot Program Filing Season 2024 After Action Report dated May 3, 2024, Publication 5969 (Direct File After Action Report),[16] the IRS estimates that the annualized cost for the USDS team is approximately $7.2 million.

Direct File plays a role in a stronger, comprehensive tax filing system. Filing a tax return is a legal obligation and a civic duty for nearly all adult Americans. The core mission of the IRS is to meet taxpayers where they are, give them options to interact with the IRS in ways that work for them, and help them meet their tax obligations as easily and quickly as possible.

Question. You have stated that the IRS could make use of artificial intelligence (AI) to identify potential tax cheats. AI has been used by other revenue agencies around the world with bad results for taxpayer rights and the protection of personal data.

In testimony before the Finance Committee in 2021,[17] former National Taxpayer Advocate Nina Olson describes how the use of AI in Australia and the Netherlands violated taxpayer rights and put personal information at risk. Ms. Olson notes that the Australian Government's "Online Compliance Intervention" program wrongfully sent debt notices to 470,000 welfare recipients and resulted in a 1.2-billion Australian dollar cost to the government which included settlement of a lawsuit. In the Netherlands, the System Risk Indicator, which was established by the Dutch Government to collect information including tax data, was found by a Hague District Court to violate data protection provisions in the European Convention on Human Rights.

Given that AI has already been used for tax purposes in many countries and has resulted in multiple instances of taxpayer rights being violated and personal date being misused, how will you ensure that any use of AI by the IRS will be transparent, remain subject to human oversight, and respect taxpayer rights?

Answer. In compliance with Federal requirements to support transparency, the IRS has submitted our AI use cases each year to Treasury to be published in the Treasury AI use case inventory).[18] The IRS is additionally standing up policies and processes to ensure compliance with new OMB M–24–10 [19] requirements for the use of AI considered rights-impacting or safety-impacting, which includes requirements relating to human oversight and respecting taxpayer rights, including privacy. These policies mandate transparency through the AI use case inventory, the completion of privacy assessments where required (such as when an AI system uses personally identifiable information), human oversight of and accountability for AI decision-making, and regular human review of any AI used in IRS operations. Full details on these policies are available in interim guidance RAAS–10–0524–0001, Artificial Intelligence Governance and Principles.[20]

Question. Internal Revenue Code (IRC) section 6751(b)(1) requires that IRS personnel obtain approval in writing from their immediate supervisor of their determination before a penalty may be assessed. Failure to follow this code section has led to assessed penalties being thrown out in court. In some of these instances, the IRS was found to have backdated documentation of supervisor sign-off of penalties.

Given the IRS has struggled to abide by IRC 6751(b)(1) without the use of artificial intelligence (AI), what specific policies and procedures will the IRS have in place to ensure AI doesn't result in taxpayers being inundated with penalties that have not met the requirements enacted by Congress? Who will be considered to be the supervisor of any AI system?

Answer. AI is used to revise our models for identifying returns that are potentially noncompliant. None of IRS's models consider penalties at all. In addition, a person will risk-assess the returns identified by the AI models before a decision is made to open an examination. During the course of the examination, an examiner

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[16] *See* IRS Direct File Pilot Program Filing Season 2024 After Action Report dated May 3, 2024, Publication 5969, *https://www.irs.gov/pub/irs-pdf/p5969.pdf*.

[17] *https://www.finance.senate.gov/download/051121-olson-testimony*.

[18] *See* Artificial Intelligence (AI) Use Cases, U.S. Department of the Treasury, *https://home.treasury.gov/data/ai_inventory*.

[19] *https://www.whitehouse.gov/wp-content/uploads/2024/03/M-24-10-Advancing-Governance-Innovation-and-Risk-Management-for-Agency-Use-of-Artificial-Intelligence.pdf*.

[20] Full details on these policies are available in interim guidance RAAS–10–0524–0001, Artificial Intelligence Governance and Principles, *https://www.irs.gov/pub/foia/ig/spder/interim-guidance-raas-10-0524-0001-artificial-intelligence-governance-and-principles-redacted.pdf*.

considers whether penalties are appropriate and obtains their immediate supervisor's personal, written approval when appropriate.

Question. The IRS strategic operating plan, issued in April of 2023, includes as a goal to "[d]evelop and implement a plan to improve the IRS Whistleblower Program." While that plan is being developed, conditions for IRS whistleblowers have not improved.

The most recent annual report for the IRS Whistleblower Office for FY 2022 details the increasing lengths of time whistleblower need to wait for a reward, if they ever get one. The average wait time for awards under Internal Revenue Code (IRC) section 7623(a), under which the IRS has more discretion to pay what are generally smaller awards, is 9.79 years. The average wait time for IRC section 7623(b), which more specifically defines the size of the awards and generally applies to higher-dollar cases, is 11.24 years. Many whistleblowers face immediate negative consequences for whistleblowing and risk being ostracized from their careers, so these incredibly long wait times are not fair and discourage others from coming forward.

What are appropriate targets for the length of time it takes the IRS to pay awards under 7623(a) and 7623(b)? While it is a good sentiment, unless specific goals are set in terms of days, months, or years, "as soon as possible" is not an adequate goal for driving real change in how the Whistleblower Office operates.

Answer. The Whistleblower Office is unable to set a processing goal for the overall time that it takes from claim submission to payment of an award because of statutory and regulatory requirements. Under the whistleblower statute, awards are paid from the proceeds of amounts collected by reason of a whistleblower's information. The IRS must collect such proceeds with finality before making an award payment. Finality occurs when the proceeds have been collected and the taxpayer no longer has a right to seek a refund of the proceeds. Before an award can be paid, the Treasury Regulations require a final determination of tax with respect to any action, that Whistleblower Office has determined the award, and either all appeals of the Whistleblower Office's determination are final, or the whistleblower signed a waiver agreeing to the determination.

The length of time for the administrative and judicial actions are varied. Often, the best whistleblower claims involve novel and complex issues. The examination may take several years. If the taxpayer appeals, goes to court, and/or appeals the court's decision it can take several more years. Collection can also take many years as the IRS generally has 10 years from the date of assessment to collect. The Whistleblower Process Timeline illustrates the process flow with general time frames for the various steps. When the underlying actions move swiftly through the processes, the Whistleblower Office is able to pay the award in a relatively short period of time. In each of the past three fiscal years, the Whistleblower Office has paid out several awards within 4 years of the date the whistleblower's claim was received. There were also several awards paid out more than 14 years from the date the whistleblower's claim was received.

The only aspect the Whistleblower Office can control regarding the timeliness of paying awards is how quickly the award is paid once all the statutory and regulatory requirements are met. The Whistleblower Office has a goal to pay awards within 90 days of this date. On average, section 7623(b) claims were paid within 67 days of the date when all requirements were met in FY 2023. This was in improvement of 1 day from the prior year.

In FY 2023, the Whistleblower Office also measured how quickly the Preliminary Award Recommendation letters were being issued for section 7623(b) using the applicable date for interest on whistleblower awards that was introduced in section 6 of the draft IRS Whistleblower Program Improvement Act of 2021 (subsequently included in the draft IRS Whistleblower Program Improvement Act of 2023 and later, the draft Taxpayer Assistance and Service Act) as the measurement point. The Whistleblower Office found that Preliminary Award. Recommendation letters were issued on average, 217 days before the applicable date in the draft legislation.

Question. At the close of the Tax Year 2023 filing season it has been reported that the IRS met a goal of 100,000 users for the Direct File pilot out of an estimated 19 million eligible tax filers.[21]

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[21] *https://www.washingtonpost.com/business/2024/04/15/irs-direct-file-reviews/*.

Another article from earlier in April notes that "[i]n January, IRS officials said they expected several hundred thousand taxpayers could use direct file during the current tax filing season."[22]

There is a significant difference between several hundred thousand and 100,000. How and when did the IRS determine that 100,000 was the goal of the pilot?

How many Direct File users completed and filed Federal returns using the pilot program? How many taxpayers started a return using the pilot program, but did not file a return?

Answer. Over the course of the pilot, more than 3.3 million taxpayers started the Direct File Eligibility Checker, 423,450 taxpayers logged in to Direct File, and 140,803 taxpayers submitted accepted returns. More detailed information about the number of Direct File return and acceptance rates can be found in IRS Publication 5969, IRS Direct File Pilot Program: Filing Season 2024 After Action Report, May 3, 2024, available at *https://www.irs.gov/pub/irs-pdf/p5969.pdf*.

Question. Since the IRS Direct File pilot was not able to file State returns, the tax-exempt entity Code for America partnered with State tax agencies to provide a State filing capability for users of Direct File.[23] The announcement from Code for America notes that "Direct File users will be able to disclose their Direct File information to our tool."

How was Code for America selected to partner with Direct File?

Did the IRS select them, or did individual States make the choice?

Answer. Code for America was not involved in Direct File at the IRS. The States that participated in the Direct File pilot could choose any approach to making an integrated tool available in their State. It was the State's decision to choose vendors or award State contracts, and none of those vendors had contracts with the IRS.

Question. Recently, an activist working as a contractor for the IRS was able to access taxpayer information, steal that information, and make it publicly available.

What protections are in place for taxpayer information shared with Code for America to file State returns?

How is taxpayer information transmitted to Code for America stored and who has access to it?

Answer. Code for America is under the same obligations to protect taxpayer data as any other Modernized e-File transmitter and is required to safeguard taxpayer data in compliance with the requirements of IRS Publication 3112: IRS e-file Application and Participation, IRS Publication 4164: Modernized e-File (MeF) Guide for Software Developers and Transmitters, and Revenue Procedure 2007–40.

Question. A former IRS contractor, Charles Littlejohn, was recently sentenced to 5 years in prison for disclosing thousands of tax returns without authorization.[24] This individual apparently stole the tax information of former President Trump and thousands of other taxpayers and disclosed this information to news organizations.

Does the IRS know the full scope of information that was improperly accessed and stolen by this individual?

Answer. It was only after Mr. Littlejohn was sentenced in February 2024, that the IRS was able to access information regarding all affected taxpayers. The data set the IRS received from the TIGTA is voluminous and complex. The IRS is working with TIGTA to process and analyze this data to fully understand and identify which taxpayers and what data Mr. Littlejohn unlawfully disclosed.

Question. How many taxpayers and what specific forms, in what numbers, where stolen by this individual?

Answer. As noted above, the IRS is working to identify the taxpayers, forms, and data elements that were stolen and disclosed.

Question. Have all taxpayers whose information was accessed without authorization or stolen been notified and informed of the taxpayer information at issue?

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[22] *https://thehill.com/business/4570215-irs-direct-file-program-struggles-to-find-users-after-late-launch/*.

[23] *https://codeforamerica.org/news/providing-easy-and-free-state-filing-for-irs-direct-filers/*.

[24] *https://www.justice.gov/opa/pr/former-irs-contractor-sentenced-disclosing-tax-return-information-news-organizations.*

Answer. As of May 31, 2024, a total of 70,666 notification letters have been mailed out. The IRS is continuing to process and analyze the data that Mr. Littlejohn unlawfully disclosed to understand and identify additional taxpayers who may need to be notified.

Question. Have steps been taken to prevent further dissemination of the stolen taxpayer information and has the IRS offered any remediation, such as free credit monitoring, to affected taxpayers?

Answer. We have seen no indication thus far that Mr. Littlejohn disclosed tax information to any persons outside of the two news organizations referenced in his sentencing. The IRS has screening and review procedures in place to identify and address potential identity theft and/or tax refund fraud. We have not seen any indication this taxpayer information was used in any way for identity theft or tax fraud. The IRS did not offer credit monitoring because the unauthorized disclosure occurred over 36 months ago, was not perpetrated for the purpose of identity theft or tax refund fraud, and we have not identified any indication of identity theft for tax refund fraud.

Question. On April 16, 2024, I wrote you about the IRS holding Federal employees accountable who fail to file and pay their taxes. As millions of Americans pay their taxes, they must be assured that the Internal Revenue Service (IRS) holds Federal employees accountable who fail to pay their taxes. In 1993, the IRS established the Federal Employee/Retiree Delinquency Initiative (FERDI) to promote tax compliance among current and retired Federal employees by collecting and publishing a report about tax delinquent Federal employees.[25] On March 6, 2023, the Treasury Inspector General for Tax Administration (TIGTA) issued a report titled, "The IRS Has Not Adequately Prioritized Federal Civilian Employee Nonfilers."[26] That report showed, in part, "the Federal civilian workforce increased by 6 percent between FY 2015 and 2021" yet "there was a 32-percent increase in the number of delinquent Federal civilian taxpayers during the same period."[27] In FY 2021, the last fiscal year the report studied, 149,000 Federal employees owed approximately $1.5 billion in unpaid taxes.[28] TIGTA also found that 42,000 Federal employees repeatedly failed to file their tax returns for multiple years between FY 2016 and FY 2020, and the IRS knows the identity of these individuals.[29] The report found that of the top 10 agencies with repeat nonfilers, the U.S. Postal Service and Department of Veterans Affairs were first and second, respectively.[30]

TIGTA reported that more enforcement is needed to deter Federal employees from willfully failing to file their taxes.[31] However, IRS disagreed with TIGTA's recommendation that the IRS should work with the Justice Department to develop referral criteria for non-filing federal employees with multiple years of unfiled tax returns for investigation and prosecution stating that the IRS has a "well-established process."[32] TIGTA's response to this disagreement indicates that the IRS's referral process is flawed, noting the following:

> We identified over 17,000 repeat Federal civilian employee nonfilers who had not filed an income tax return for three or more years. Yet, these employees continued in their Federal jobs, with pay and benefits, without adequate IRS enforcement scrutiny.[33]

Federal employees have a heightened responsibility to be compliant in paying their tax obligations.[34] As TIGTA recommended, the IRS should prioritize cases where Federal employees are in brazen noncompliance with tax laws by failing to file their tax returns and, in some cases, for several years.[35] The IRS's apparent enforcement failures against Federal employees is unacceptable. Taxpayers deserve to be assured that Federal employees, whose salaries and benefits are funded through

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[25] Treasury Inspector General for Tax Administration, The IRS Has Not Adequately Prioritized Federal Civilian Employee Nonfilers, 2023–30–011 (March 6, 2023), *https://www.tigta.gov/sites/default/files/reports/2023-03/202330011fr.pdf*.
[26] *Id*. at 2–3.
[27] *Id*.
[28] *Id* at 4.
[29] *Id*.
[30] *Id* at 5.
[31] *Id*. at 4.
[32] *Id*. at 13.
[33] *Id*. at 14.
[34] 5 CFR part 2635.809.
[35] TIGTA, *supra* note 1 at 22.

taxpayer dollars, are held to account by the IRS for failing to pay their taxes just like the rest of the American people are held to account.

Provide copies of the FERDI Annual Report from Fiscal Year 2020 to present.

Answer. We are happy to work with you to get you the information you need.

Question. Provide, in detail, the steps IRS has taken, and will take, to implement the report's recommendations and hold Federal employees accountable for failing to file tax returns and pay taxes.

Answer. We have already updated the FERDI section of the IRM to include fraud indicator check sheets and links to fraud procedures to help our Campus Collection employees identify fraud in FERDI case. Our IRS Office of Fraud Enforcement (OFE) delivered Fraud Awareness presentations in January 2024 as part of annual FERDI training for employees in all our Campus Call Sites.

Per TIGTA's recommendation, we shared their report with Treasury's Office of Tax Policy for them to consider legislative proposals to amend section 7203, making willful nonfiling a felony, and also section 6103 to allow the IRS to share essential compliance return information with other Federal agencies upon the IRS's identification of a current Federal employee who is tax-delinquent. Treasury included the proposal to amend § 7203 in the General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals.[36]

Following the report's recommendation, our Research, Applied Analytics, and Statistics (RAAS) Division analyzed the 42,047 taxpayers TIGTA cited in their report as Federal employee nonfilers and RAAS determined 3,712 of these taxpayers had 2 or more open, unfiled returns, as of March 2023.

Since willfulness is a requirement to develop and submit fraud referrals to our CI division, RAAS used data available under the Bank Secrecy Act to identify 163 of these cases with possible indicators of fraud. They worked with our OFE function to determine which cases had potentially had enough indicators to establish that these taxpayers willfully failed to file their tax returns. In February 2024, we assigned the accounts with sufficient willfulness indicators to Field Collection revenue officers who will work with OFE personnel and refer the accounts to CI if appropriate.

Other efforts coming out of the report are still in progress and on track to be completed by the implementation date outlined in our management response to TIGTA. These include:

- Ensuring FERDI balance due and delinquent return cases are worked as a top priority in collection programs and designated FERDI sites;
- Sending taxpayers Automated Collection System (ACS) Letter 26—which requests the taxpayer to file their tax return immediately—within 30 days of the case moving into a stand-alone Taxpayer Delinquency Investigation (TDI) inventory;
- Completing programming to update ACS Letter 39 (reminder letter) with language to help taxpayers address their outstanding delinquent return(s); and
- Executing a programming fix to ensure FERDI taxpayer delinquency investigations are not removed from active inventory.

In our continuing effort to improve tax compliance and ensure fairness, we announced a new initiative on February 29, 2024, in IR–2024–56,[37] to restart nonfiler compliance programs. The initial effort is focused on high-income taxpayers who failed to file Federal income tax returns in more than 125,000 instances since 2017. In April 2024, we completed issuing nonfiler notices to every taxpayer who has an unfiled tax return, some as far back as to 2017, with reported income of $400,000 or more. These include FERDI cases that meet this criterion. We are in the process of issuing return delinquency notices on the remaining noncompliant high income nonfilers, including the FERDI sub-set of this population.

Question. Are you able to dispute the following TIGTA statement: "We identified over 17,000 repeat Federal civilian employee nonfilers who had not filed an income

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[36] *See* General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals, *https://home.treasury.gov/system/files/131/General-Explanations-FY2025.pdf*.

[37] *See* I.R.S., IR–2024–56, IRS launches new effort aimed at high-income nonfilers; 125,000 cases focused on high earners, including millionaires, who failed to file tax returns with financial activity topping $100 billion (February 29, 2024), *https://www.irs.gov/newsroom/irs-launches-new-effort-aimed-at-high-income-non-filers-125000-cases-focused-on-high-earners-including-millionaires-who-failed-to-file-tax-returns-with-financial-activity-topping-100-billion*.

tax return for 3 or more years. Yet, these employees continued in their Federal jobs, with pay and benefits, without adequate IRS enforcement scrutiny." If so, describe in detail with facts and evidence what steps the IRS has taken to hold the "17,000 repeat Federal civilian employee nonfilers" accountable to the taxpayer. If not, why did you disagree with the recommendation to develop referral criteria for Federal employee nonfilers with multiple years of unfiled tax returns?

Answer. To clarify, the number of 17,000 was not intended to represent the total number of Federal employees currently delinquent in filing returns. In Figure 2 of the report, TIGTA provided a chart showing 42,047 Federal civilian employees who failed to file a return for 2 or more years during FY 2016 through FY 2020. In footnote 15, TIGTA stated the number cited was not intended to represent the current status of the delinquent modules, such as how many were currently in open delinquent return status. As explained above, out of TIGTA's list of 42,047 taxpayers, which includes the 17,000, we determined only 3,712 had two or more delinquent returns. Our civil functions will refer those cases with sufficient willfulness indicators to CI for their consideration.

We will prioritize processing those cases we do not refer to CI once we fully resume nonfiler processes. For example, FERDI nonfilers who qualify for the Automated Substitute for Return Program (ASFR) will be a priority in the program. If the result of an ASFR is a tax assessment that goes unpaid, the taxpayer may then be included in the IRS's Federal Payment Levy Program, which allows the IRS to levy 15 percent of Federal employee salaries. Our civil collection functions may take additional appropriate actions on FERDI balance due accounts that go unpaid including filing Notices of Federal Tax Liens, issuing levies, and referring cases with fraud indicators to CI for further consideration.

CI has a well-established process for referring cases to the Department of Justice. The IRS disagreed with TIGTA's recommendation to create a separate referral process for Federal employee nonfiler cases. The Department of Justice does not accept or deny cases for prosecution based on generalized sets of referral criteria. Under current law, the willful failure to file a tax return is a misdemeanor. The likelihood of a criminal investigation and prosecution of a failure to file misdemeanor is relatively low given CI's and the Department of Justice's limited resources to prosecute offenders and competing priorities. Both agencies invest resources in prosecuting felonies that are likely to result in a substantial period of incarceration and provide the most effective deterrence.

As noted above, the Treasury included a legislative proposal in the FY 2025 Treasury Greenbook related to this issue. Specifically, the proposal would make repeated failure to file a tax return a felony for an individual who was a nonfiler for 3 years within a 5-year period and had an aggregate tax loss of at least $250,000. If failure to file was a felony, CI would be more likely to strategically dedicate additional resources to those investigations.

QUESTION SUBMITTED BY HON. JAMES LANKFORD

Question. The point of the Administrative Procedure Act and Executive Order 12866 is to ensure rules are thoroughly scrutinized and reviewed by the OMB's Office of Information and Regulatory Affairs (OIRA) before they bind the American people. In June 2023, under Executive Order 12866, OMB and Treasury signed an updated memorandum of agreement (MOA) effectively removing tax regulations from OIRA centralized review.

In your response to my question on the MOA, you characterized the process as "a different path than other agencies," but noted that the IRS continues to work with OIRA.

Please detail the IRS's interagency review process and coordination with OIRA for tax regulations. Please specify if every tax regulation is subject to the process.

Will you commit making to making the process with OIRA and subsequently captured tax regulations publicly available?

Answer. All tax regulations are coordinated with the OIRA. When other executive branch agencies may have an interest in the tax regulation that is not significant enough to effectively incorporate employees of the other agencies into the drafting team, Treasury coordinates with those agencies. A Notice of Planned Regulatory Act, referred to as a 7-point memorandum, is submitted to OIRA for every tax regulation. The Chief Counsel Directives Manual, which is publicly available on *irs.gov,*

contains this process. CCDM Part 32.1.2.3 (4) (August 16, 2018) identifies a 7-point memorandum as being submitted to OMB related to Executive Orders 12866 and 13563. The 7-point memorandum process and the content of a 7-point memorandum can be found at CCDM Part 32.1.2.4 (November 12, 2019), OMB Notice of Planned Regulatory Action (7-Point Memo). Sample 7-point memoranda can be found as exhibits in CCDM Part 32.1.2–3 and 32.1.2–3.

QUESTIONS SUBMITTED BY HON. TIM SCOTT

Question. As you are aware, several cases in which IRS employees misled taxpayers and the U.S. Tax Court regarding the backdating of penalty documents have recently come to light. In one of those backdating cases, *Lakepoint Land II, LLC,* the Tax Court found that IRS employees acted in "bad faith" and failed to correct their previous "misrepresentations of fact." Our tax system depends on the public having confidence they are being treated fairly, and such behavior by IRS employees severely erodes that confidence. This committee and the public need to know that such illegal behavior will not be tolerated.

Can you assure me that the employees who backdated penalty documents and/or misled the Tax Court will be disciplined for their acts?

Answer. It is critical to our tax compliance system that taxpayers and the courts have the utmost confidence in the IRS's work. The IRS and IRS Office of Chief Counsel (Chief Counsel) must vigorously pursue our mission and enforce the tax laws fairly. In doing so, we hold ourselves to the highest standards of candor to the court, integrity, and fairness toward taxpayers. We must meticulously ensure compliance with the letter and spirit of the rules and laws that govern our operations. And if we fall short in this, we must promptly make things right.

In that respect, the IRS and Chief Counsel are committed to ensuring that only properly approved penalties are being pursued. The IRS conducted mandatory penalty approval training for all Large Business and International examiners and managers involved in the development and approval of penalties and for all SB/SE Field Examination examiners and managers. In addition to the mandatory training, similar penalty approval training has been offered to other employees. Chief Counsel conducted mandatory training for all Chief Counsel attorneys and managers in fall 2023, which addressed section 6751(b) compliance as well as our ethical obligations. In May 2024, Chief Counsel held its annual mandatory ethics training, which included a discussion of candor to the court and the requirement to correct previously submitted erroneous factual or legal statements.

The IRS is pursuing appropriate accountability measures for employees who did not comply with required standards. Without getting into any particular personnel matter, the IRS will take all appropriate measures, including discipline, in addressing conduct issues.

Question. Direct File Is Tax Preparation. Commissioner, you have now told the Senate Finance and Ways and Means Committees that Direct File is not tax preparation; that taxpayers are preparing their own returns and Direct File is simply a platform to help them do that.

Please explain your reasoning for this assertion. In other words, is it your view that commercial tax software companies likewise are not engaged in "tax preparation"? If the differentiation here is that there is no compensation paid by the Direct File users for the Direct File service, does this then mean that commercial tax software companies participating in the IRS Free File Program are not engaged in tax preparation (since no compensation is paid by the taxpayer who in that context either)?

Answer. Direct File is an online tool provided by the IRS that allows taxpayers to file their returns for free, directly with the IRS. It uses an interview-based platform to help taxpayers self-prepare their own returns. Direct File guides taxpayers through the process of preparing a tax return by asking questions which the taxpayer can answer without needing to consult other instructions or IRS publications. Direct File uses these answers to fill out the forms and schedules of a tax return, which the taxpayer can review and choose to electronically file.

You asked whether commercial tax software companies and companies that participate in IRS Free File are engaged in "tax preparation." The IRC does not define "tax preparation," but it does define "tax return preparer." Under the IRC, the definition of "tax return preparer" depends on the specific provision that is referenced.

Generally, a tax return preparer is defined in section 7701(a)(36)(A) as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title." See Treas. Reg. § 301.7701–15; see also Circular 230, § 10.2(a)(8). Here, the IRS does not prepare returns for compensation or employ others to prepare returns for compensation. Rather, Direct File is a free tool for taxpayers to prepare their own returns. Companies participating in the Free File program are not tax return preparers, as defined in section 7701(a)(36), if they do not prepare for compensation any tax returns or claims for tax refunds for taxes imposed under the IRC.

Moreover, section 7701(a)(36)(B) provides that a person is not a tax return preparer if the person merely provides "typing, reproducing, or other mechanical assistance." A computerized tax return preparation service is considered to be a tax return preparer under section 7701(a)(36) only if it provides substantive determinations, beyond mere typing, reproducing, and other mechanical assistance. See Rev. Proc. 85–187, 1985–2 C.B. 338. Direct File does not make substantive determinations as to the correctness of the reported amounts shown on the return. Finally, note that under Treas. Reg. § 301.7701–15(f)(1)(i), any official or employee of the IRS performing official duties is not a tax return preparer.

Question. Number of Users. Why did the Treasury Department and IRS lower the estimated number of Direct File users from "several hundred thousand" to about 100,000?

Answer. When the IRS set a goal of having hundreds of thousands of taxpayers use Direct File and 100,000 accepted returns, it wanted to ensure that enough taxpayers used Direct File to provide the IRS with enough data to adequately evaluate the pilot. Each additional user had the potential to help the IRS learn something new about Direct File and its users.

Question. The U.S. Government Accountability Office (GAO), in its recent report on Direct File, stated that the purported "benefits" of Direct File (*e.g.,* easier to use, lower compliance burdens for taxpayers, increased take-up of credits and deductions) were not substantiated by the IRS. At the Senate Finance hearing on April 16th, you stated that Direct File is not intended to be better or worse than commercial tax preparation software. Do you agree that the purported benefits of Direct File that are claimed by advocates of the "pilot" are in fact unsubstantiated and illusory?

Answer. No. The after-action report that the IRS published this spring showed the benefits of Direct File as well as ways the IRS can improve the tool going forward. The pilot was a year-long effort to study the interest in—and feasibility of—creating a direct e-filing system as a new option for taxpayers to file Federal income tax returns. Direct File is an important part of the effort to meet taxpayers where they are, give them choices as to what best meets their needs when interacting with the IRS, or otherwise meet their tax obligations as easily and quickly as possible. And it is a key component of the modernization efforts, which were detailed in the IRS strategic operating plan.

During the pilot, the IRS worked to answer whether a direct e-filing option was feasible. The IRS assembled a team of some of the smartest and most experienced tax experts, digital product specialists, engineers, pilot strategists, and data scientists from across the Federal Government. They studied the challenges, met with tax officials from dozens of States, and designed a pilot for a system that is secure, accurate, easy to use—and free. The Direct File platform used this filing season contained more than 350 screens. Under the hood were more than 1,000 "facts" representing information about the filer's tax situation.

By design, the Direct File Pilot started out gradually to allow the team to test the new system. In February, we began testing Direct File with a handful of volunteer Federal and State government employees. The team continuously refined and strengthened the system based on its technical performance and feedback from its first users. Over several weeks, the IRS incrementally opened the system to new users in short availability windows before fully launching Direct File on March 8th.

Throughout this filing season, the IRS saw strong interest in Direct File from taxpayers throughout the country. Millions of people—including many from outside of the 12 pilot States—visited the Direct File website to learn about the new system. Over the course of the pilot, more than 3.3 million taxpayers started the Eligibility Checker to see if they could use Direct File; 423,450 taxpayers logged into Direct File; and 140,803 taxpayers submitted accepted returns. In cases where a user's tax

situation was out of scope for the pilot, they were directed to other options to complete their tax returns. Direct File issued more than $90 million in tax refunds and collected $35 million in tax balances due.

Overall, usage was in line with the IRS's expectations for the limited pilot, and it far exceeded what was necessary to provide sufficient data for evaluation. In the filing season's final weeks, the percent growth in accepted returns submitted through the Direct File system outpaced the growth in total returns accepted by the IRS across all platforms. During the final week, more than 5,000 taxpayers submitted returns each day using Direct File, and the system stood up well under the high-volume push of the tax season's final days.

A key aspect of the pilot was learning more about what taxpayers expect from this kind of system. More than 15,000 Direct File users participated in the GSA's Touchpoints survey, which collects comprehensive user feedback about government systems. In the GSA Touchpoints survey about Direct File:

- Ninety percent of respondents ranked their experience as Excellent or Above Average.
- When asked what they particularly liked, respondents most commonly cited Direct File's ease of use, trustworthiness, and that it was free.
- Additionally, 86 percent of respondents said that their experience with Direct File increased their trust in the IRS.
- Ninety percent of survey respondents who used customer support rated that experience as *excellent* or *above average*.

Direct File's users told the IRS that the system saved them time—filing their taxes with Direct File generally took less than an hour, and many reported filing in as little as 30 minutes. One taxpayer even said it was fun. Nearly half of Direct File users reported paying for tax preparation last year, and Treasury estimates that Direct File users saved $5.6 million in tax preparation fees. More than 4 percent of Direct File users report filing on paper last year. One lesson the IRS will focus on is how to ease the transition from paper to electronic filing.

The cost to develop the Direct File pilot came in much lower than initial estimates. Through the end of the pilot, the total amount spent by IRS was $24.6 million, including the Report to Congress. Direct File's operational costs—including customer service, cloud computing, and user authentication—were just $2.4 million. To build and run the pilot, the IRS also engaged the USDS. The IRS's agreement with the USDS does not involve costs to IRS.

Based on the pilot's success in meeting the operational challenges, widespread interest from millions of taxpayers across the country, and positive feedback from Direct File users, I recommended to Secretary Yellen that the IRS make Direct File a permanent option to file Federal tax returns next year.

Question. Please provide an explanation for why the IRS chose to commandeer the IRS Free File Program homepage by putting information related to IRS Direct File at the top of that page? Didn't this decision just lead to taxpayer confusion?

Answer. When the Direct File pilot became available to the general public, the IRS expanded the webpage that outlines free filing options to include all free filing options so taxpayers could choose the filing option that best met their needs. The webpage outlined the various free filing options and provided links to each of them in order to clarify the differences between the various options and avoid taxpayer confusion. In addition, the IRS also maintained a separate page dedicated to just the IRS Free File program.

Question. Please provide the committee with an explanation for why the IRS Free File Program—incorrectly derided as "failed"—finished the tax-filing season with 10.5 percent more returns than the previous year?

Answer. Direct File plays a role in a stronger, comprehensive tax filing system. Filing a tax return is a legal obligation and a civic duty for nearly all adult Americans. The core mission of the IRS is to meet taxpayers where they are, give them options to interact with the IRS in ways that work for them, and help them meet their tax obligations as easily and quickly as possible.

The IRS took giant leaps in accomplishing that mission when the Free File Alliance launched in 2003 and the agency worked with Free File to offer fillable PDF forms in 2008. Direct File is a critical part of the IRS's ongoing modernization effort, and an important component of a stronger, comprehensive tax filing system that gives taxpayers choices of electronic filing options that best suit their needs.

We learned from the pilot there is strong interest in no-cost filing options across the country. Millions of taxpayers who did not live in one of the 12 pilot States visited the Direct File website to learn more about this option or asked live chat assistors to make Direct File available in their State.

As a permanent filing option, Direct File will continue to be one option among many from which taxpayers can choose. We have heard from many taxpayers that they prefer to file their taxes directly with the IRS, and 86 percent of Direct File users reported that their experience with Direct File increased their trust in the IRS. We also know from public polling that many taxpayers prefer to work with a third party, whether that is a trusted tax professional or use tax preparation software (both free and commercial). The IRS will continue to support all filing options.

We remain committed to the IRS's ongoing relationship with the Free File Alliance. Free File and the tax preparation software industry have been critical partners in serving taxpayers for 2 decades. This year, Free File saw an increase of about 200,000 tax returns filed through the program, reaching 2.9 million returns, an increase of 7.3 percent from the 2.7 million filed through the same period last year. In May, the IRS announced the extension of the Free File program through 2029, assuring that it will continue to be a key component of the tax filing system through the end of the decade. As we work to expand the Direct File system, we will also strengthen free filing options for taxpayers, because giving taxpayers additional options strengthens the entire tax filing system.

Question. While the proponents of Direct File have lauded the "pilot" as a "success," isn't it true that the take-up rate by taxpayers was a fraction of 1 percent (*i.e.,* 140,000 users out of 19 million eligible taxpayers, or .007)?

Answer. Over the course of the pilot, more than 3.3 million taxpayers started the Direct File Eligibility Checker, 423,450 taxpayers logged in to Direct File, and 140,803 taxpayers submitted accepted returns. More detailed information about the number of Direct File return and acceptance rates can be found in IRS Publication 5969, IRS Direct File Pilot Program: Filing Season 2024 After Action Report, May 3, 2024, available at *https://www.irs.gov/pub/irs-pdf/p5969.pdf.*

Question. Is it true that the IRS has the technological know-how to monitor every keystroke of users of the Direct File tool? Did IRS monitor taxpayer key strokes at any time during the Direct File "pilot?"

Answer. No, the IRS is not monitoring the keystrokes of Direct File users while they are using the Direct File application or any other IRS application.

Question. Of the 12 States where the Direct File "pilot" was offered, please provide a breakdown of the usage of Direct File by the State in which the taxpayer lives. In other words, how many Massachusetts residents used Direct File? How many from Tennessee used Direct File, and so on?

Answer. In the IRS's Direct File After Action Report, we provided a breakdown of taxpayer usage by State (see footnote 2). That breakdown by State can be found in Figure 4 on page 17 of the report.

QUESTIONS SUBMITTED BY HON. JOHN THUNE

Question. Though many Americans receive a tax refund, recent reporting indicates that IRS backlogs have led to significant delays in hundreds of millions of dollars being refunded to taxpayers despite the tens of billions of dollars appropriated to your agency through the IRA. For example, TIGTA found that hundreds of millions of dollars in taxpayer funds from the 2020 tax year still have yet to go out the door.

Can you please speak to why this problem continues to go unresolved and outline the specific steps the IRS is taking to get these refunds back to taxpayers and how you all plan to avoid these years-long delays going forward?

IRS RETURN PROCESSING OPERATIONS

Answer. The COVID–19 pandemic era was an immensely trying period for taxpayers and for the agency. Filing season bottlenecks caused severe delays, with many Americans waiting months for their returns to be processed and refunds issued. The IRS took numerous actions to return to normal levels in our original return processing programs by the end of CY 2022, entering the 2023 filing season with normal inventories. In 2024, taxpayers have continued to see major improvements original return processing, with the IRS delivering one of the best filing sea-

sons the Nation has seen in years, processing all timely received original individual returns that requested a refund and did not require error correction or special handling.

For individual tax returns received in the current year, we process returns for which refunds are due first. The IRS issues more than 9 out of 10 refunds in less than 21 days. Some returns require additional review and take longer, regardless of whether the return was filed electronically or on paper.

We encourage individual taxpayers to check "Where's My Refund?" on *irs.gov* [38] for a personalized refund status within 24 hours after the IRS accepts their e-filed tax return. The "Where's My Refund?" tool updates once every 24 hours, usually overnight. This tool has a tracker that displays a return's progress in three stages: Return Received, Refund Approved, and Refund Sent. Taxpayers receive personalized refund information based on the processing of their tax return. The tool also provides an actual refund date as soon as the IRS processes the tax return and approves the refund.

We also regularly update information on *irs.gov* to realistically reflect our processing time frames. We encourage taxpayers to visit our "Status of Operations" page[39] for the latest information and updates on individual and business returns.

MODERNIZATION EFFORTS

IRA funding has enabled the IRS to have historically strong 2023 and 2024 filing seasons. We have a tremendous amount of transformation work taking place at the IRS and we remain focused on improving and modernizing services to taxpayers. We have hired additional employees to address accumulated inventories and launched initiatives to modernize workstreams that permits electronic submission of documents by taxpayers and allows work to be processed electronically. Return submissions go into inventory immediately, allowing us to maintain one inventory workable in a first-in, first-out order that is accessible by all employees working the respective programs, regardless of their physical locations.

We have made critical progress on our paperless processing initiative. While online options for taxpayers have increased, the IRS has continued to be flooded with paper, including tax returns and correspondence. We had been working toward digital scanning of paper forms and returns for some time, but IRA funding has allowed us to greatly accelerate these efforts. For example, during Calendar Year (CY) 2023, we scanned more than 1.5 million forms and returns we received on paper. In CY 2024 through September 20th, we have scanned over 2 million forms and returns we received on paper.

We have developed innovative tools which automate the processing of error conditions on returns that prevent them from processing through to completion and would otherwise require review and action by an employee. This both expedites case closures and reduces overall inventory, permitting employees to focus on more complex issues.

We have also expanded the capabilities of the IRS Online Account for Filing Season 2024, allowing taxpayers to perform more types of transactions in their accounts, including viewing digital copies of select IRS notices. Taxpayers who want to check their account information including balance, payments, tax records and more, can log into their IRS online account. It's a simple and secure way to get information fast.

Moreover, we now have technology, known as the Document Upload Tool, that gives taxpayers the option of submitting documentation online through *irs.gov*. This allows taxpayers who receive certain notices requiring them to send information to the IRS to electronically upload documents rather than mailing them in, helping reduce time and effort resolving tax issues. This provides immediate benefits to taxpayers, who have nearly instant confirmation that documents were received by the IRS.

Question. In December, TIGTA found that certain IRS computers and mobile devices used by Criminal Investigation employees continued to have access to TikTok. This is unacceptable. That is why a few months ago, Senator Blackburn and I sent a letter requesting additional information from you regarding the failure of the IRS

[38] *See https://www.irs.gov/wheres-my-refund.*
[39] *See https://www.irs.gov/help/processing-status-for-tax-forms.*

to comply with the Federal law banning TikTok—an app that is directly tied to the Chinese Communist Party—on government devices.

Why did the IRS refuse to block access to TikTok on the 2,800 mobile devices and 900 computers identified in this TIGTA report and what specific steps have you taken to remove access to TikTok on these devices?

Answer. Please see my response to your letter dated May 23, 2024, which answers the questions you raised.

Question. This Inspector General report also revealed that the IRS has not updated its "Bring Your Own Device" policies, which allow IRS personnel to use their own personal devices for business purposes. Therefore, IRS personnel can potentially access TikTok on the personal devices that are also used to access personally identifiable taxpayer information.

When will the IRS, if it hasn't already, update its guidance on the BYOD program to ensure the ban of TikTok on government devices extends to personal devices participating in the BYOD program?

Furthermore, given the highly sensitive nature of the information that IRS employees have access to and the IRS's troublesome data security record, do you believe it is appropriate for the IRS to administer a BYOD program at all?

Answer. The IRS Bring Your Own Device (BYOD) program is a voluntary program that allows personnel to use their personally owned mobile devices to stay connected to, access data from, or complete many IRS tasks. Internal Revenue Manual 10.5.1.6.13, provides an overview of the BYOD program and the related requirements to protect highly sensitive and legally protected taxpayer data.

To protect the privacy of the tax information, BYOD participants must only use IRS-approved applications provided by IRS through a secure container on the device. They must also adhere to all applicable laws, regulations, rules, policies, and procedures, including Federal Records Act, Office of Government Ethics Standards of Ethical Conduct, and the Department of the Treasury Employee Rules of Conduct. In addition, BYOD users must consent to monitoring, interception, recording, reading, copying or capturing by authorized personnel of all activities on the IRS-approved mobile device business software on their mobile devices.

To access IRS resources, the user must have their device enrolled in the BYOD program, have the container software installed, and use both a passcode to unlock the device and a password when using an application within the container to access IRS data. The applications used within the container and information accessed on the personal device is encrypted and fully separate from the user's personal applications and data. If the device is lost or stolen, the user is required to report the theft immediately.

QUESTIONS SUBMITTED BY HON. TODD YOUNG

Question. As we discussed during the hearing, my constituents continue to run into difficulty resolving outstanding issues with the IRS. I appreciated your comments committing to focusing on better success in addressing these concerns.

What specific steps do you plan to take to better address substantive taxpayer issues, such as assisting victims of identity theft, addressing individuals whose paper returns have not been processed in a timely manner, and resolving taxpayer disputes?

Answer. A tremendous amount of transformation work is taking place at the IRS. We remain focused on improving and modernizing services to taxpayers in the areas you mention.

IDENTITY THEFT VICTIM ASSISTANCE (IDTVA)

The IRS takes identity theft seriously and is committed to resolving these cases as quickly as possible. We are taking steps to reduce our case resolution time frames with the following efforts:

- **Adding additional Customer Service Representatives (CSRs).** More IDTVA employees have been trained on full scope identity theft. Additional employees have also been trained on non-tax related IDTVA. The assignment of IDTVA CSRs to IDT paper inventory has been prioritized by limiting toll-free phone assignments when able.

- **Overtime.** Funding has been allocated to the IDTVA program to increase the pace of case resolution.
- **Enhanced Review of IDTVA Cases.** We are reviewing identity theft cases to determine which cases we can close systemically or move to another area within the IRS if they were referred to IDTVA in error.
- **Education.** We are providing additional guidance, explaining when filing a Form 14039, Identity Theft Affidavit, is needed.
- **Processing Improvements.** We implemented the Form 14039 Digital Upload Tool to allow taxpayers to submit their Form 14039 directly to the IRS electronically. We are also working to identify process improvements.
- **Case Identification.** We are working to identify IDTVA cases that fit within identified criteria to pre-identify the fraudulent return for the IDTVA caseworker. This will reduce the amount of research needed and improve efficiencies.

RETURN PROCESSING

We have made critical progress on our paperless processing initiative. While online options for taxpayers have increased, the IRS has continued to be flooded with paper, including tax returns and correspondence. We had been working toward digital scanning of paper forms and returns for some time, but IRA funding has allowed us to greatly accelerate these efforts. For example, during CY 2023, we scanned more than 1.5 million forms and returns we received on paper. In CY 2024 through April 19th, we have scanned nearly 900,000 forms and returns we received on paper.

For individual tax returns received in the current year, we process returns for which refunds are due first. The IRS issues more than 9 out of 10 refunds in less than 21 days. Some returns require additional review and take longer, regardless of whether the return was filed electronically or on paper.

We encourage taxpayers to check "Where's My Refund?" on *irs.gov* (see footnote 33) for a personalized refund status within 24 hours after the IRS accepts their e-filed tax return. The "Where's My Refund?" tool updates once every 24 hours, usually overnight. This tool has a tracker that displays a return's progress in 3 stages: Return Received, Refund Approved, and Refund Sent. Taxpayers receive personalized refund information based on the processing of their tax return. The tool also provides an actual refund date as soon as the IRS processes the tax return and approves the refund.

We also regularly update information on *irs.gov* to realistically reflect our processing time frames. We encourage taxpayers to visit our "Status of Operations" page for the latest information and updates on individual and business returns. (Also, see I.R.S., IR–2024–56 published February 29, 2024) at the following link: *https://www.irs.gov/newsroom/irs-launches-new-effort-aimed-at-high-income-non-filers-125000-cases-focused-on-high-earners-including-millionaires-who-failed-to-file-tax-returns-with-financial-activity-topping-100-billion*.

TAXPAYER INQUIRIES AND SERVICE

Along with the IRS's annual discretionary budget, the 10-year IRA investment is transforming the IRS so we can provide best-in-class service to taxpayers. Taxpayers are beginning to see the benefits of an IRS with predicable multiyear funding. That funding is already providing a better experience for taxpayers, who have had access to expanded tools and resources during the 2024 tax season (as of April 20, 2024), including:

- **Expanded in-person hours.** The IRS added extended hours at 242 Taxpayer Assistance Center (TAC) locations across the Nation, generating nearly 13,000 extra service hours for taxpayers during the 2024 filing season. In addition to extended service hours, the IRS also offered taxpayer assistance on Saturdays in more than 70 locations. These evening and Saturday hours made it more convenient for thousands of hardworking taxpayers to get help.
- **Improved phone service.** Continuing a trend seen last year following the addition of 5,000 new telephone assistors, the IRS level of service on its main phone lines reached nearly 88 percent, this filing season. That level is above the 87-percent level seen last year and more than a five-fold increase from the phone service levels seen during the pandemic era period, when the level of service was at just 15 percent in 2022.

- **Faster response times.** Taxpayers waited, on average, just over 3 minutes for help on the IRS main phone lines. This wait time is consistent with what was delivered during filing season 2023 and less than the average of 28 minutes delivered during filing season 2022.
- **More calls answered.** The IRS answered more taxpayer calls on its live assistor lines this filing season, a 17.3-percent increase from 2023. IRS assistors answered over 9.0 million calls, up from 7.7 million during the 2023 filing season. IRS automated lines answered approximately 8.9 million calls, 458,000 more than the previous year.
- **More callback options.** The IRS offered callback options on 97 percent of the phone lines this filing season. The agency offered callback for over 4.6 million taxpayers this tax season, more than double the 2.2 million calls in 2023. This option, offered when phone lines were busy, saved taxpayers nearly 1.5 million hours of wait time on the phones.
- **Additional free help at volunteer sites.** The IRS saw tax return preparation work at volunteer sites increase to approximately 2.7 million returns this tax season, up nearly 300,000 from last year following work at Volunteer Income Tax Assistance and Tax Counseling for the Elderly sites.
- **More in-person help.** The IRS helped 212,000 more taxpayers in-person this filing season than in 2023. IRS employees at TACs served 784,000 taxpayers this year, up from 572,000 in 2023, a 37-percent increase.
- **Enhanced paperless processing.** This offering will enable taxpayers to submit digitally all correspondence, non-tax forms and responses to notices that don't have a filing or payment requirement. And taxpayers can now e-file additional tax forms that previously had to be filed on paper.
- **Enhanced IRS Individual Online Account.** This improvement includes chat, the option to schedule and cancel future payments, revise payment plans and validate and save bank account information.

If your office has constituent-specific concerns, we will research and address those inquiries if your staff provides us with the appropriate privacy release forms.

Question. Earlier this year, Charles Littlejohn was sentenced to prison for disclosing thousands of tax returns to *ProPublica.* As you know, my Republican colleagues and I were frustrated that it took the IRS and the Department of Justice so long to identify the leaker and bring him to justice. Looking to the future, I am concerned that another IRS employee, whether they be full-time or government contractors, may inappropriately exploit their access to the most sensitive taxpayer information for political gain.

Do you believe it is important to maintain taxpayer privacy and uphold current law with respect to the confidentiality of taxpayer information, "yes" or "no"?

Answer. Yes. Let me start with this critical point: Any improper disclosure of taxpayer information is absolutely unacceptable. The actions taken by the wrongdoer mentioned above, were a heinous betrayal of public trust, not just to taxpayers but also to the IRS employees who work hard and take great pride protecting the Nation's tax information. I strongly believe that maintaining taxpayer privacy and upholding the laws governing confidentiality of taxpayer information is arguably the most important role the IRS performs to administer the tax system. There should be no question that IRS staff across the Nation take great pride serving taxpayers and take very seriously their obligation to safeguard confidential taxpayer information.

Question. What protections have you put in place at the IRS to prevent this violation of taxpayer privacy from happening ever again?

Answer. When I arrived as IRS Commissioner in March 2023, safeguarding taxpayer information was a priority for me, and I quickly focused on using new Inflation Reduction Act resources to bolster the agency's data security. In addition to reviewing the report, the IRS has taken multiple steps to improve the safeguarding of taxpayer data. These measures include:

- **Further restricting user access.** We restructured our operations to reduce the number of people with access to the most sensitive taxpayer datasets. Stronger protocols are now in place to ensure only people with documented, mission-essential needs are entitled to receive access.

- **More robust protective security controls.** We updated data protection mechanisms (*e.g.,* encryption, anonymization) to better protect taxpayer information.
- **More frequent data entitlement reviews.** We are strengthening review protocols to ensure more IRS oversight of data users, have implemented procedures to ensure that all network access is timely removed for users who separate from the IRS. So far, we have reduced timeframes for deactivating inactive accounts assigned to current employees and contractors by 25 percent. Managers are required to review and approve initial requests for access and to periodically validate continuing user need for the access. IRS Cybersecurity will conduct additional reviews to ensure we limit access to key sensitive systems to properly authorized individuals.
- **Collection and retention of detailed access logs.** Key data sources inside the IRS have improved monitoring and event logs. We now maintain evidentiary copies of database queries and data outputs, which improves surveillance of internal data use and preserves records of who accessed which data and when. Additionally, we enforce an approved destination for data exports and prevent users from copying those files to unapproved drives and/or folders.
- **Improved firewalls.** We have added additional firewalls between key taxpayer information and the rest of the IRS, providing additional monitoring capabilities. We record all traffic between these areas to improve monitoring.
- **Stronger 24/7 monitoring.** We have expanded advanced analytics to detect and prevent risky data usage, providing improved insight into suspicious activities around the clock.
- **New tools.** We are adding new analytical tools and dashboards to monitor user activity involving sensitive data. These tools will help to improve the detection of potential data misuse.
- **Less removable media.** We have dramatically reduced users' ability to connect removable media, such as thumb drives, to IRS computers. The new protocol requires executive approval of those users who have legitimate business needs and close monitoring of user activity to watch for risky behavior. This step has significantly curtailed opportunities to remove sensitive taxpayer information from the IRS computing environment.
- **Tighter email controls.** We have dramatically strengthened email controls involving taxpayer information, including new restrictions on contractors' ability to email information outside the IRS, while preserving but closely monitoring this ability when necessary for collaborating with non-IRS employees. This step has further reduced the risk of contractors removing sensitive taxpayer information from the IRS computing environment.
- **New printer controls.** We are now logging and scanning printing by all IRS users to detect potential policy violations and to preserve evidence to support inquiries of suspected wrongdoing. This effort includes printing at telework/remote work locations.

Question. What kind of continuous monitoring does the IRS conduct to identify whether taxpayer data is being accessed or shared in violation of Federal law?

Answer. We have implemented 24/7 monitoring using advanced analytics to detect and prevent risky data usage. This includes establishment of a process for monitoring user behavior to detect potential insider threats originating from either intentional or inadvertent misuses of taxpayer information. Once the potential misuse is identified by IRS Cybersecurity, the user's manager must evaluate and report whether the user behavior was sanctioned. Lack of IRS manager confirmation results in a referral to the TIGTA Office of Investigations for further investigation. Last year, the IRS further improved the detection of potential policy violations, leveraging our investment in modern software solutions, deployment of hundreds of detection algorithms, and increased sophistication in our advanced analytics. These enhancements resulted in a significant increase in user behavior flagged for review and investigation. We have implemented streamlined procedures for IRS cybersecurity personnel to, in appropriate cases, immediately revoke user access to IRS systems to ensure protection of our sensitive data.

The IRS also implemented a new Insider Threat Hub to enhance internal information sharing on potential insider threats. In 2023, the hub enhanced employee inci-

dent monitoring and established new standard operating procedures. We continue to strengthen oversight, enhance metrics, and prioritize hundreds of risk indicators, with significant emphasis on improved monitoring of IRS contractors. We have sharply expanded insider threat monitoring capabilities to conduct continuous internal surveillance for any inappropriate user activity involving sensitive taxpayer information and to facilitate swift action in response to actual threats and policy violations.

Question. In the press release announcing the roll out of IRS's Direct File pilot program, Deputy Secretary of Treasury Wally Adeyemo stated the goal of launching this service was to "save taxpayers time and money they can spend on themselves and their families." While I think we can all agree that saving taxpayers time and money is a laudable goal, the cost of the initial rollout has raised some questions regarding whether it actually saves taxpayers time and money.

How much has the IRS spent on the creation of Direct File so far? In your estimate, please include: any funds that the Treasury Department has spent on Direct File; funds you have spent on advertising and promoting Direct File; resources from the OMB Digital Service team, which I understand has also been involved in the development of Direct File; and any other vendors or Federal agencies you have used or are currently using and the costs associated with them.

Answer. See below.

Question. How does the cost of the Direct File pilot program compare to the cost to the government of the existing Free File system offered by certain tax preparation organizations?

Answer. See below.

Question. Do you commit to providing this committee with a report analyzing the per-return costs to the government of Direct File, Free File, and the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs within 60 days?

Answer. In the report to Congress, the IRS estimated that the annual cost for Direct File could range from between $64.3 to $248.9 million for a service that reached between 5 to 25 million taxpayers depending on the tax scope and the taxpayers reached. We noted that these estimates were subject to uncertainty due to the nature of launching a new product like Direct File. The pilot provided an opportunity to collect concrete data on the cost of Direct File. Through April 20, 2024, the IRS spent $24.6 million on Direct File, which includes $11.6 million in costs for the development of last year's report to Congress. Of the $13.0 million spent on pilot development and implementation, $10.6 million is technology and product development costs and $2.4 million is operational costs (customer service, cloud computing, user authentication, et cetera). The limited design of the pilot means that the IRS was not able to benefit from economies of scale. If the number of Direct File users were to increase, the cost per return would decrease. Note: FY 2024 labor includes actuals through April 6, 2024 and an accrual through April 20, 2024. Costs do not include other shared corporate costs.

These totals include costs associated with vendor support and an interagency agreement with GSA's 18F. To build and run the pilot, the IRS also engaged 29 employees from the USDS to supplement the IRS employees and other team members. The USDS costs are not included in the $24.6 million spent on Direct File. The IRS estimates that the annualized cost for the USDS team is $7.2 million.

While the costs outlined above all center on the actual costs involved in delivering the pilot, the team is using this data to develop a more robust cost estimate for potential future costs for delivering Direct File.

The Direct File pilot was the largest use of live chat support within the IRS to date, and it allowed the agency to continue learning how live chat meets taxpayer preferences and expectations and how taxpayers would react when live chat was the only option for receiving assistance. This has the potential to impact IRS taxpayer service overall as the agency looks to provide taxpayers with more choices in how they can interact with the IRS.

From March 4th through April 20, 2024, Direct File staffing averaged 41 CSRs per day. This average was determined by using the total CSR hours available to chat in the system, divided by 7.5 hours of production time over a total of 47 workdays. The actual quantity of CSRs varied throughout the 15-hour workday (7:00 a.m. to 10:00 p.m. Eastern), from a low of 7 CSRs to a high of 62 CSRs. The CSRs handled 38,600 chats with an Average Handle Time of 9 minutes. Based on the

staffing available to support the pilot, the IRS had the capacity to handle approximately 450,000 Direct File chats per month. Given that approximately 10 percent of pilot participants engaged customer support, this means the IRS could have assisted 4.5 million filers with the 400 CSRs who were trained for the pilot.

Direct File plays a role in a stronger, comprehensive tax filing system. Filing a tax return is a legal obligation and a civic duty for nearly all adult Americans. The core mission of the IRS is to meet taxpayers where they are, give them options to interact with the IRS in ways that work for them, and help them meet their tax obligations as easily and quickly as possible.

The IRS took giant leaps in accomplishing that mission when the Free File Alliance launched in 2003 and the agency worked with Free File to offer fillable PDF forms in 2008. Direct File is a critical part of the IRS's ongoing modernization effort, and an important component of a stronger, comprehensive tax filing system that gives taxpayers choices of electronic filing options that best suit their needs.

We learned from the pilot there is strong interest in no-cost filing options across the country. Millions of taxpayers who did not live in one of the 12 pilot States visited the Direct File website to learn more about this option or asked live chat assistors to make Direct File available in their State.

As a permanent filing option, Direct File will continue to be one option among many from which taxpayers can choose. We have heard from many taxpayers that they prefer to file their taxes directly with the IRS, and 86 percent of Direct File users reported that their experience with Direct File increased their trust in the IRS. We also know from public polling that many taxpayers prefer to work with a third party, whether that is a trusted tax professional or use tax preparation software (both free and commercial). The IRS will continue to support all filing options.

We remain committed to the IRS's ongoing relationship with the Free File Alliance. Free File and the tax preparation software industry have been critical partners in serving taxpayers for 2 decades. This year, Free File saw an increase of about 200,000 tax returns filed through the program, reaching 2.9 million returns, an increase of 7.3 percent from the 2.7 million filed through the same period last year. In May, the IRS announced the extension of the Free File program through 2029, assuring that it will continue to be a key component of the tax filing system through the end of the decade. As we work to expand the Direct File system, we will also strengthen free filing options for taxpayers, because giving taxpayers additional options strengthens the entire tax filing system.

Question. Over the past year, I have partnered with several of my colleagues on both sides of the aisle to gain a better understanding of the potential opportunities, and areas of concern, for AI deployment.

As you evaluate budgetary needs for the IRS for Fiscal Year 2025, what role do you see artificial intelligence playing in improving customer service at the agency?

Answer. The IRS is currently using chatbots and voicebots to provide convenient multichannel avenues for taxpayers to access general information and FAQs, along with some account-specific information, without needing to wait for a live assistor.

In addition, the IRS is exploring use of AI to extract insights from customer service data to better understand common pain points and create new opportunities to streamline and improve the customer experience.

The IRS is also exploring use of AI to suggest plain language for revising taxpayer notices, with the goal of communicating more clearly to taxpayers. In this use case, AI will be used to generate a draft. IRS subject matter experts will then review the drafts before they are sent to taxpayers.

The IRS is also evaluating options to improve CSR capabilities through use of artificial intelligence. The focus is to build an integrated information system that utilizes AI to understand and summarize a taxpayer question and present the CSR with contextual specific information, thereby enabling the CSRs to answer taxpayer questions effectively and with higher efficiency.

Question. What safeguards is the agency putting in place to ensure effective and proper use of these new and emerging technologies?

Answer. The IRS AI governance process requires review by an AI Assurance Team and approval by a senior executive board prior to any in-production use of rights-impacting or safety-impacting AI. It also requires the completion of artifacts to enhance transparency and support risk evaluation and mitigation. Furthermore,

it requires regular review of all AI use cases at least annually and whenever significant modifications are made, to ensure the IRS continues to use AI safely, responsibly, and effectively.

IRS policy on AI governance and principles is codified in interim guidance RAAS–10–0524–0001, Artificial Intelligence Governance and Principles (May 20, 2024). This includes all minimum practices for rights-impacting and safety-impacting AI outlined in OMB M–24–10 (March 28, 2024), along with Treasury-specific and IRS-specific governance processes and artifacts for AI use cases (see RAAS–10–0524–0001, section 10.24.1.5).

In addition, the IRS is bound by the decisions rendered by the Treasury Artificial Intelligence Governance Board (AIGB), in which the IRS is a standing member. The AIGB helps ensure AI is implemented within the Department in a manner consistent with the Department's risk appetite, with appropriate considerations given to safety and equity.

Question. Partnerships and pass-through entities are important corporate structures that allow startups, small businesses, and other important organizations needed flexibility that allows businesses to innovate and thrive. However, there has been some criticism of partnerships abusing the tax code.

Do you believe partnerships and pass-through entity structures can benefit the economy?

What evidence have you seen that business partnerships, a longstanding structure that has helped facilitate critical innovation, have been a source of tax reporting malfeasance?

Do you believe stepped-up enforcement will be more of a deterrence of tax fraud or a more of a disincentive for viable individuals and businesses to avoid beneficial partnerships altogether?

Answer. An increasingly large amount of business activity is taking place in partnerships and pass-through entity structures. The number of partnerships and S corporation returns have increased to 9.5 million for Tax Year 2021—a 24-percent increase since 2013.[40] The number of large partnerships—entities with over $100 million in assets and 100 or more partners—have increased nearly 600 percent since 2002.[41]

The audit rate of these pass-through structures has historically been low—less than .5 percent in 2021. To restore fairness in tax compliance, in September 2023, the IRS announced it would increase attention to large partnerships and would soon open examinations of the largest partnerships, each averaging more than $10 billion in assets.

Recently identified abusive transactions such as basket option contracts and syndicated conversation easements have necessarily relied on partnership structures. Partnerships are structured in these transactions to defer tax, convert the character of income, and artificially inflate deductions.

Tax frauds and tax noncompliance are unfair to individuals and businesses that comply with tax laws. Increased enforcement coverage for partnerships—particularly large, multitiered, and publicly traded partnerships—and pass-through entity structures will help ensure fairness across the entire taxpayer population.

PREPARED STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON

The committee meets this morning to discuss the IRS budget and tax filing season, which closed just yesterday. I want to thank Commissioner Werfel for being here at a very busy time for everybody at the IRS. There are a lot of issues to discuss, and I'll begin with Direct File.

Anybody who denies that the Direct File pilot was a huge success must be living in another universe. It was open to a fairly small percentage of taxpayers, but the reviews it got from its initial users were overwhelmingly positive. Frankly, it seems like a whole lot of people were pleasantly stunned that a Federal agency—particu-

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[40] *See* Internal Revenue Service Data Book (2023), Publication 55–B, *https://www.irs.gov/pub/irs-pdf/p55b.pdf.*

[41] *See* GAO–23–106020, available at: *https://www.gao.gov/products/gao-23-106020.*

larly one as frequently vilified as the IRS—was able to build a helpful website that works.

The tens of thousands of taxpayers who used Direct File this year collectively saved millions on fees they would have paid to one of the tax software giants. The website was user-friendly. It was quick and easy to use. It didn't hassle users with upcharges for add-on services they didn't need.

In short, with Direct File, the IRS built a good tool that people like because it saves Americans time and money. No surprise then that the people who oppose it are absolutely furious and doing everything they can to stop it from expanding.

The detractors said it didn't attract enough users, but tens of thousands of new users came in over the last week, and the IRS hit its goal of 100,000 taxpayers using the system. There's no doubt this will become more popular every year.

Others have said the cost estimates were too vague. But the fact is, there's always some uncertainty with pilot programs. Now that the IRS has tested the system and set a baseline, the costs will be a lot clearer going forward.

And finally, some say this whole project was unnecessary because taxpayers have the option of using "free file" systems through the big tax prep companies. That might have been a valid argument years ago, before the tax prep giants got caught hiding free file options from eligible taxpayers and conning people into forking over hundreds of dollars they didn't need to spend. Congress simply cannot trust the big tax prep companies to do the right thing. For some, their version of free file is the freedom for Americans to pay them even more.

Bottom line: Direct File is long overdue, and it's the kind of public service the Federal Government ought to be providing to Americans wherever it can. I understand the IRS and Treasury Department are now evaluating how the pilot program went over the last few months.

I want to see this program expand. I'm looking forward to the day when Oregonians come up to me in one of our 51 Fred Meyer grocery stores—I've been to every last one—to tell me how thrilled they were to save time and money with Direct File.

On the topic of vastly improved Federal programs, I'll turn now to the IRS's continued success at improving customer service during this filing season. The IRS answered a million more calls with live assistance than it did during last year's filing season. It got call waiting times down to 3 minutes. It saved taxpayers 1.4 million hours of time that in previous years they would have spent sitting on hold. It smashed its goals for in-person service.

Despite this success, Republicans are complaining that the administration is asking for money to sustain all this progress. They seem to want to go back to the "bad old days" when taxpayers sat on hold for hours and could not get timely refunds. It makes no sense

For the second filing season in a row, the IRS is proving that it can provide a top-notch level of taxpayer service when Congress gives it the resources.

I'll close with a few words on enforcement. The IRS has announced some big enforcement efforts in the last few months. That includes cracking down on 125,000 cases where wealthy individuals—many of them people who bring in more than $1 million per year—never even filed a tax return.

There's also a new effort to root out the abuse of tax breaks for corporate jets—high-flying executives who take tax write-offs for personal travel. And in my view, the IRS ought to look at similar abuses with corporate-owned yachts. When it comes to yachts, the abuses are even more blatant. Yachts produce big write-offs, but I find it hard to believe that anybody is yachting to a board meeting.

If Congress continues to cut the IRS's funding—or if the Inflation Reduction Act funding expires and Congress doesn't add more—we know what is going to happen. Wealthy tax cheats will have an easier time getting away with breaking the law. And it'll be misery and higher costs for typical American taxpayers who are just trying to do their civic duty when tax filing season comes around every spring. That's an outcome that the vast majority of the American people oppose.

COMMUNICATIONS

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Statement of Michael Bindner

Chairman Wyden and Ranking Member Crapo, thank you for the opportunity to address this issue. Thank you for allowing me to participate in the traditional annual hearing about this time of year concerning the IRS filing season.

As I mentioned the last 2 years, support contractors could be more widely used for customer and information technology services. This would identify the balance of spending to justify the budget request for FY 2025.

Additional analytical resources are required for tax reform initiatives such as a Fair Tax initiative and exploration of options due to expiration of the Trump/Ryan/Brady tax cuts. The Ways and Means Committee and the Committee for a Responsible Federal Budget are agitating for a Fiscal Commission to justify or pay for some kind of extension of the 2017 Tax Bill.

While such an extension should be allowed to die on the vine, analytical resources should be budgeted for the debate and a consideration of alternatives, such as those presented last year to the Ways and Means Committee. My comments on those alternatives, plus a presentation of my own, are attached.

This year, the House has passed a reboot of the pandemic era child tax credit distribution. This will require more funds, although with tax reform, this could be done more cheaply. Such a change is essential in a post-*Roe* environment. If women must keep their pregnancies, then they must be funded adequately to raise the child to maturity.

To prevent the "stink of welfare" that Senator Manchin so objects to, CTC payments should be included with wages for all employees—not just those with three or more children. They should also be distributed through other federal and state assistance programs—some of which can be reduced to do so.

For middle-income taxpayers whose increased credits are less than their annual tax obligation, a simple change in withholding tables is adequate. Procedures are already in place to deliver refundable credits to larger families. For the coming year, they merely need to be expanded to all families with children.

Employers can work with their bankers to increase funds for payroll throughout the year while requiring less money for their quarterly tax payments (or estimated taxes) to the IRS. The main issue is working out those situations where employers owe less than they pay out. This is especially true for labor intensive industries and even more so for low-wage employers.

A higher minimum wage would make negative quarterly tax bills less likely. Indeed, no one should have to subsist mainly on their child tax payments.

As usual, we have attached the latest version of our tax reform plan, with a separate attachment on how implementation of this plan would affect IRS manpower. The answer is that the change would be drastic. It would also allow the committee to focus more on how social welfare is being delivered in general, as well as eliminating current roadblocks to promptly filing for Social Security Disability Income.

Thank you, again, for the opportunity to add our comments to the debate. Please contact us if we can be of any assistance or contribute direct testimony.

Attachment One—Tax Policies to Expand Economic Growth and Increase Prosperity for American Families, December 6, 2023

Consumption-Based Taxation in an International Setting, Alan J. Auerbach

Professor Auerbach provides a good summary of consumption-based taxes, but then describes the Destination Based Cash Flow Tax, which he favors. This proposal leaves the current tax system which forces most households to file income tax—where a shift to an employer paid tax with deductions for family support and a goods and services tax would take the trash out of the tax system. His proposal assumes the continuation of the corporate income tax, both in the United States and abroad. The employer-paid subtraction VAT, adopted by our trading partners, would tax locally to provide services to families while exempting these services from border adjustment—thus ending the incentive to avoid these taxes and the associated benefits.

In summary, the DBCFT is a small ball solution that keeps the complexity of corporate profits taxes intact—and adds to it.

Addressing the Long-Term Fiscal Imbalance With a Value-Added Tax, Alan Viard

Mr. Viard provides a textbook explanation of Value-Added Taxation, but leaves adjustments to the income tax system that everyone must file intact. His assumption that income tax increases are impossible is short sighted, especially as these taxes are about to increase automatically if nothing is done. Indeed, the baseline for calculating income tax revenue must be the permanent rate, not the current rate which is soon to expire. **Tax Reform MUST NOT be an excuse to leave income tax rates at their current level.**

Adding a value-added tax must be part of a more comprehensive solution—including levying income taxes solely on the highest 1 percent (although the top 20 percent would have subtraction VAT surtaxes paid for them by their employers on wages and dividends—with capital gains taxes being repealed in favor of a different tax). The remaining income tax would range between 6.5 percent and 26 percent—which is also the range for the VAT Surtax. As discussed below, the remaining personal income tax would go toward paying interest on the national debt and paying down a portion of the principal.

Americans for Tax Reform, Grover Norquist

Mr. Norquist is opposed to any revenue measure, despite the fact that when taxes are more progressive, the economy improves. This is shown by historic data included in our May comments to the House Budget Committee which demonstrated that when progressive income taxes are reduced, deficit spending must occur to avoid or recover from a recession (or worse). The reduction in growth that occurred before the Pandemic was one point lower than before the Tax and Job Cuts Act (not a typo) was enacted—this includes a 1-year lag for investors to pocket their tax cuts and invest in the latest investment scam, such as crypto currency and single family home rental mortgage backed securities—while household consumption (and income) similarly declines.

Revenue is at historic lows as a percentage of Gross Domestic Product. Letting the TCJA expire as scheduled will be healthy for the economy, for households and does not violate the precedent that letting tax cuts expire does not trigger Mr. Norquist's pledge, which was set in 2013. Member conformity to Mr. Norquist's will is no longer the standard for most far-right Republicans. It is now supporting former President Trump and excusing or minimizing the events of January 6, 2021 (which will have no impact on future criminal proceedings for Mr. Trump or any who assisted in the planning of that day's events).

I propose actual tax reform—reform that simplifies the tax system while distributing burden equitably.

Americans for Fair Taxation, Stephen L. Hayes

Mr. Hayes begins his testimony claiming he is not a tax economist. Given the impact of his proposal on low-income households and the boon his proposal is to high-income households, I agree with his assessment. The idea of a national consumption tax is meritorious, as long as it is not a single tax.

Unless he includes gambling at the Wall Street Casino as a consumable good covered under the Fair Tax, while retaining some kind of surtax for very high-income individuals (one as part of the Fair Tax that employers remit—as Lawrence B. Lindsey suggested—and the second as residual high-income tax that can be remitted

early as a tax prepayment bond, thus reducing interest on the debt), his suggestion is profoundly unfair.

The Fair Tax proposal includes incentives for tax avoidance that a value-added tax removes. There are already tax breaks for individuals and firms who collect income taxes—as such taxes are a deduction. With a VAT, such taxes are a CREDIT that is fully refundable. If I were selling a product, I would much rather have the full credit and not have to look over my shoulder for auditors looking to see if I am misusing the exclusion of wholesale goods.

The Fair Tax replaces income distributed to families through the child tax credit with a prebate that only covers the Fair Tax—a substantial income loss that would either force more people into very low wage jobs—those akin to slavery—or force the government to restore Aid for Families with Dependent Children (welfare) and Food Stamps to levels higher than when President Clinton reformed welfare as we knew it.

The subtraction VAT we propose takes the government out of redistribution almost entirely—save for payments of child tax credits to families receiving disability or unemployment benefits—with employers receiving tax benefits to provide adequate, family size sensitive, wages instead. Such a proposal would both benefit families, make work pay (along with increases to the minimum wage) and increase economic growth and household savings.

The final flaw in Mr. Hayes' proposal is that it always comes around when income tax rates cuts are scheduled to expire. A single tax proposal which assumes the permanent baseline could not pass. The rate would be too high. America can do better—and it would be fairer.

The Tax Policy Center, Len Burman

Professor Burman addresses wage stagnation and the prospect that technological advancement may make it worse. He would use a universal earned income tax credit to remedy this. My answer to this is increasing the minimum wage. The UEITC would solidify the two-tiered economy.

The other factor which has led to economic inequality is bad math. By bad math, I mean the rewarding of cost-of-living adjustments (which are an unearned benefit) on a percentage basis, rather than an equal dollar basis. Because prices follow the 90th percentile (with one half of total adjusted growth income under that point, with the other half above—counting dollars, not people), most families do worse each year. Only product improvement and social programs, such as the Child Tax Credit, allow most families to avoid starvation. Whether this effect is accidental or intentional is a matter for more systematic study.

From here on in, adjust for cost of living on a per dollar an hour rather than on a percentage basis (or dollars per month or week for federal beneficiaries). Calculate the dollar amount based on inflation at the median income level. No one gets more dollars an hour raises, no one gets less dollars per hour in increases. Increase the minimum wage as above and consider decreasing high end salaries paid to government employees and contractors. Even without decreases, simply equalizing raises will soon reduce inequality.

Burman echoes the proposal to restore the child tax cut to pandemic era level. I would double that, but take the IRS out of the income distribution business—as previously discussed. He and I agree on the Fair Tax—although I would use the term Fair Tax for a VAT as part of a multi-tax reform. Doing so extracts money spent by heirs and plutocrats who borrow from their fortunes to buy companies and luxuries. If they buy companies or take them public, they would pay an asset value-added tax (see below). Our proposals would end tax shelters. Tax expenditures for health care, family incomes, daycare and the eventual shift to employee ownership to replace much of the employer contribution to FICA are not shelters, they are basic reforms.

The Center for Fiscal Equity Solution

A single tax will never provide enough revenue while being politically acceptable. We propose a series of taxes, which are detailed in the appendix, which will still prove easier to collect and administer than the current income tax system.

The tax gap leaves revenue on the table. Neither a wealth tax, nor the President's proposal to tax capital gains at death should pass. Indeed, a wealth tax simply multiplies the problems of capital gains taxation. It is time for the nation to shift away from taxing short term capital gains taxes at nominal rates and preferred rates for

long-term gains. Instead, set one rate for all transactions and shift from end of the year reconciliation to an asset value-added tax for each transaction.

At initial public offering, option exercise and the first sale after inheritance, gift or donation, the sale would logically be marked to market. If a family keeps the stock or company, there will be no tax until someone else buys it. The second tax cut would be to expand the ESOP tax exemption to all sales of public stock, rather than just private stock. Maximizing employee ownership will bring a new level of motivation and excellence to the economy.

The 2017 personal income tax changes should not be made permanent or extended, as has been proposed. This will reward savings and speculation, rather than providing an incentive to invest in plants and equipment. The latter responds to greater levels of consumption by households funded by both the public and private sectors, including Social Security recipients.

Our latest comprehensive tax reform proposal is in the attachment. We propose replacing the complexity of the Earned Income Tax Credit with a floor on FICA contributions by employees and a lower ceiling to reduce the amount of funding for high-income households. The employer contribution would be shifted from employers to consumers (but not exporters) to the Fair Tax—which would also fund domestic discretionary spending and domestic military basing and operations.

This should be operated like a Value-Added Tax—in other words, the deduction of sales taxes paid would be replaced with a tax credit for such payments. This change should be made, even without enactment of the Fair Tax. To not do so is to force companies to pay tax on tax—something that the uninitiated thing the VAT does, but in reality, this is what happens in the current tax system due to its extreme complexity.

Rather than providing for a rebate and shifting the more generous portions of the child tax credit (which is the most anti-abortion provision in law) to direct subsidy, expand the child tax credit and distribute it with Unemployment Insurance, Social Security old-age, survivors and disability insurance and wages (including stipends paid for those in educational and work experience programs to raise them out of poverty).

The child tax credit would be an offset to a subtraction value-added tax, as well as a credit for providing employee health insurance. This will replace all Obamacare subsidies and the health insurance exclusion to corporate income taxes. Corporate income taxes would be abolished. The base level of the subtraction VAT should be a wash—with taxes fully offset by credits for the average business above 50 employees. Some firms would even get a rebate if their credits are greater than their tax obligations.

Personal income tax filing on wage and dividend income for middle income households will be replaced with a subtraction value-added tax surtax for income above the ceiling for FICA employee contributions, which will be graduated from a 6.5-percent rate to a 26-percent rate for income over $425,000.

At $500,000, an individual surtax ranging between 6.5 percent and 26 percent would fund net interest payments, debt reduction and paying down the Social Security Trust Fund. For this reason, these payments will be made to the Bureau of the Public Debt. The Asset VAT will be collected by the SEC. The subtraction VAT, any carbon added tax and the Fair Tax will be collected by the states (who will also do any auditing on tax collection issues). What would happen to the IRS? Abolition.

Attachment Two—Tax Reform, Center for Fiscal Equity, March 24, 2023

Synergy: The President's Budget for 2024 proposes a 25-percent minimum tax on high incomes. Because most high-income households make their money on capital gains, rather than salaries, an asset value-added tax replacing capital gains taxes (both long- and short-term) would be set to that rate. The top rate for a subtraction VAT surtax on high incomes (wages, dividends and interest paid) would be set to 25 percent, as would the top rate for income surtaxes paid by very high-income earners. Surtaxes collected by businesses would begin for any individual payee receiving $75,000 from any source at a 6.25 percent rate and top out at 25 percent at all such income over $375,000. At $450,000, individuals would pay an additional 6.25 percent on the next $75,000 with brackets increasing until a top rate of 25 percent on income over $750,000. This structure assures that no one games the system by changing how income is earned to lower their tax burden.

Individual payroll taxes. A floor of $20,000 would be instituted for paying these taxes, with a ceiling of $75,000. This lower ceiling reduces the amount of benefits received in retirement for higher income individuals. The logic of the $20,000 floor reflects full time work at a $10 per hour minimum wage offered by the Republican caucus in response to proposals for a $15 wage. The majority needs to take the deal. Doing so in relation to a floor on contributions makes adopting the minimum wage germane in the Senate for purposes of Reconciliation. The rate would be set at 6.25 percent.

Employer payroll taxes. Unless taxes are diverted to a personal retirement account holding voting and preferred stock in the employer, the employer levy would be replaced by a goods and receipts tax of 6.25 percent. Every worker who meets a minimum hour threshold would be credited for having paid into the system, regardless of wage level. All employees would be credited on an equal dollar basis, rather than as a match to their individual payroll tax. The tax rate would be adjusted to assure adequacy of benefits for all program beneficiaries.

High-income Surtaxes. As above, taxes would be collected on all individual income taxes from salaries, income and dividends, which exclude business taxes filed separately, starting at $400,00 per year. This tax will fund net interest on the debt (which will no longer be rolled over into new borrowing), redemption of the Social Security Trust Fund, strategic, sea and non-continental U.S. military deployments, veterans' health benefits as the result of battlefield injuries, including mental health and addiction and eventual debt reduction.

Asset Value-Added Tax (A–VAT). A replacement for capital gains taxes and the estate tax. It will apply to asset sales, exercised options, inherited and gifted assets and the profits from short sales. Tax payments for option exercises, IPOs, inherited, gifted and donated assets will be marked to market, with prior tax payments for that asset eliminated so that the seller gets no benefit from them. In this perspective, it is the owner's increase in value that is taxed. As with any sale of liquid or real assets, sales to a qualified broad-based Employee Stock Ownership Plan will be tax free. These taxes will fund the same spending items as high income and subtraction VAT surtaxes. There will be no requirement to hold assets for a year to use this rate. This also implies that this tax will be levied on all eligible transactions.

The 3.8-percent ACA–SM tax will be repealed as a separate tax, with health-care funding coming through a subtraction value-added tax levied on all employment and other gross profit. The 25-percent rate is meant to be a permanent compromise, as above. Any changes to this rate would be used to adjust subtraction VAT surtax and high income surtax rates accordingly. This rate would be negotiated on a world-wide basis to prevent venue seeking for stock trading.

Subtraction Value-Added Tax (S–VAT). Corporate income taxes and collection of business and farm income taxes will be replaced by this tax, which is an employer paid Net Business Receipts Tax. S–VAT is a vehicle for tax benefits, including:

- Health insurance or direct care, including veterans' health care for non-battlefield injuries and long-term care.
- Employer paid educational costs in lieu of taxes are provided as either employee-directed contributions to the public or private unionized school of their choice or direct tuition payments for employee children or for workers (including ESL and remedial skills). Wages will be paid to students to meet opportunity costs.
- Most importantly, a refundable child tax credit at median income levels (with inflation adjustments) distributed with pay.

Subsistence-level benefits force the poor into servile labor. Wages and benefits must be high enough to provide justice and human dignity. This allows the ending of state administered subsidy programs and discourages abortions, and as such enactment must be scored as a must pass in voting rankings by pro-life organizations (and feminist organizations as well). To assure child subsidies are distributed, S–VAT will not be border adjustable.

As above, S–VAT surtaxes are collected on all income distributed over $75,000, with a beginning rate of 6.25 percent. replace income tax levies collected on the first surtaxes in the same range. Some will use corporations to avoid these taxes, but that corporation would then pay all invoice and subtraction VAT payments (which would distribute tax benefits). Distributions from such corporations will be considered salary, not dividends.

Invoice Value-Added Tax (I–VAT). Border-adjustable taxes will appear on purchase invoices. The rate varies according to what is being financed. If Medicare for All does not contain offsets for employers who fund their own medical personnel or for personal retirement accounts, both of which would otherwise be funded by an S–VAT, then they would be funded by the I–VAT to take advantage of border adjustability.

I–VAT forces everyone, from the working poor to the beneficiaries of inherited wealth, to pay taxes and share in the cost of government. As part of enactment, gross wages will be reduced to take into account the shift to S–VAT and I–VAT, however net income will be increased by the same percentage as the I–VAT. Inherited assets will be taxed under A–VAT when sold. Any inherited cash, or funds borrowed against the value of shares, will face the I–VAT when sold or the A–VAT if invested.

I–VAT will fund domestic discretionary spending, equal dollar employer OASI contributions, and non-nuclear, non-deployed military spending, possibly on a regional basis. Regional I–VAT would both require a constitutional amendment to change the requirement that all excises be national and to discourage unnecessary spending, especially when allocated for electoral reasons rather than program needs. The latter could also be funded by the asset VAT (decreasing the rate by from 19.25 percent to 13 percent).

Carbon Added Tax (C–AT). A Carbon tax with receipt visibility, which allows comparison shopping based on carbon content, even if it means a more expensive item with lower carbon is purchased. C–AT would also replace fuel taxes. It will fund transportation costs, including mass transit, and research into alternative fuels. This tax would not be border adjustable unless it is in other nations, however in this case the imposition of this tax at the border will be noted, with the U.S. tax applied to the overseas base.

Attachment Three—Tax Administration, Treasury Budget, February 12, 2020

Shifting to a single system for all business taxation, particularly enacting invoice value-added taxes to collect revenue and employer-based subtraction value-added taxes to distribute benefits to workers will end the need for filing for most, if not all, households. Any remaining high salary surtax would be free of any deductions and credits and could as easily be collected by enacting higher tiers to a subtraction VAT.

Subtraction VAT collection will closely duplicate the collection of payroll and income taxes—as well as employment taxes—but without households having to file an annual reconciliation except to verify the number of dependents receiving benefits.

Tax reform will simplify tax administration on all levels. Firms will submit electronic receipts for I–VAT and Carbon Added Tax (C–AT) credit, leaving a compliance trail. S–VAT payments to providers, wages and child credits to verify that what is paid and what is claimed match and that children are not double credited from separate employers.

A–VAT transactions are recorded by brokers, employers for option exercise and closing agents for real property. With ADP, reporting burdens are equal to those in any VAT system for I–VAT and A–VAT and current payroll and income tax reporting by employers.

Employees with children will annually verify information provided by employers and IRS, responding by a postcard if reports do not match, triggering collection actions. The cliché will thus be made real.

High-salary employees who use corporations to reduce salary surtax and pay I–VAT and S–VAT for personal staff. Distributions from such corporations to owners are considered salary, not dividends.

Transaction-based A–VAT payments end the complexity and tax avoidance experienced with income tax collection. Tax units with income under $84,000 or only one employer need not file high salary surtax returns. Separate gift and inheritance tax returns will no longer be required.

State governments will collect federal and state I–VAT, C–AT, S–VAT payments, audit collection systems, real property A–VAT and conduct enforcement actions. IRS collects individual payroll and salary surtax payments, performs electronic data

matching and receive payments and ADP data from states. SEC collects A–VAT receipts.

I-VAT gives all citizens the responsibility to fund the government. C–AT invoices encourage lower carbon consumption, mass transit, research and infrastructure development. A–VAT taxation will slow market volatility and encourage employee ownership, while preserving family businesses and farms. Very little IRS Administration will be required once reform is fully implemented. All IRS employees could fit in a bathtub with room for Grover Norquist.

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INTRODUCTION

Chairman Wyden, Ranking Member Crapo, and members of the Committee, I would like very respectfully to submit the following statement to you on the appearance of IRS Commissioner Werfel before your distinguished committee.

I have been a tax practitioner for almost 50 years, active in promoting good tax policy—especially tax simplification—through serving in leadership positions of national nonpartisan professional organizations, and am the author of many tax policy articles (including a dozen in *The Wall Street Journal* in recent years) and a book on tax history. I am also an avid follower of Congressional tax hearings.

Commissioner Danny Werfel is the most enthusiastic commissioner in my many years of observing the office. I respect Mr. Werfel and hope that his tenure will be very successful.

However, I respectfully object to his proposal to expand mandatory efiling, as it will burden taxpayers with more complexity in order to save IRS from needed improvements to management.

MANDATED EFILING

Businesses understand that communication should be as simple and smooth as their customers require, leading to a great customer experience. At IRS, the customer must adapt to the government's often complex and incomprehensible methods. This often leads to frustration, confusion, and noncompliance.

Regarding Commissioner Werfel's written testimony, I strongly object to his proposal that would require efiling by all individuals with income tax returns showing gross income of $400,000 or more, and 10 other efiling mandates.[1] This is for the benefit of IRS, and a heavy burden on taxpayers. It would allow IRS to further burden taxpayers with onerous tax compliance requirements while freeing IRS from dealing with the paperwork it unnecessarily adds to the process.

TAX FORM PROLIFERATION

Efiling has fueled the mind-boggling proliferation of tax forms, whether filed on paper or efiled. IRS wants taxpayers to deal with its two thousand form portfolio of ever-increasing complexity, but doesn't itself want to deal with the paperwork it inflicts on taxpayers.

The 2-page Form 1040 now requires up to 8 pages, including two lines for reporting Olympic medal winnings.[2] The 2-page Schedule D can require up to 8 pages. A 20-page Schedule K–3 must be computed and attached to *each* partnership or S corp K–1, and one 19-page K–2 to the main return.

Up to four 2-page Due Diligence Forms 8867 must be attached to returns claiming common tax credits or head of household status, subject to a $600 preparer penalty for each omitted form. A new Form 7206, Self-Employed Health Insurance Deduction, adds 14 lines for each business that provides SE health insurance for the taxpayer.

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[1] Written Testimony of Daniel Werfel, Commissioner Internal Revenue Service, Before the Senate Finance Committee on the Filing Season and the IRS Budget, April 16, 2024, p. 13, *https://www.finance.senate.gov/hearings/the-presidents-fiscal-year-2025-irs-budget-and-the-irs-2024-filing-season.*

[2] Form 1040, Schedules 1, 2, and 3, each two pages. Olympics at Schedule 1 lines 8m and 24c.

These extra forms make tax returns bigger, more complex, costly, and treacherous to prepare, surely reducing compliance and accuracy because the larger the return, the more difficult to review. It costs IRS nothing extra to process—unless the return is filed on paper. IRS tests to determine if a software vendor's product meets efiling standards, but may not test whether tax software guides taxpayers to prepare correct and accurate returns.[3] Too many pages are daunting and discourage taxpayers from reviewing the returns presented for their approval.

EFILING HAS PROBLEMS

Though IRS rejects even the most trivial impropriety or error in efiling, IRS cuts no slack for taxpayers or their preparers who don't notice that they failed to receive an IRS acceptance confirmation (not just software provider's confirmation that a return was submitted).

IRS National Taxpayer Advocate, Erin Collins, calls paper, "kryptonite,"[4] demonstrating contempt for traditional filing practices. Paper forms originate with IRS and IRS is burying taxpayers in it, not the other way around. Back in 2011, then NTA Nina Olson, recommended that "IRS should allow taxpayers to voluntarily turn off the ability to efile" as protection against identity theft,[5] a crime that is still proliferating.

Efiling is still costing billions in identity theft and other types of fraud. IRS claims it "identified $5.5 billion in tax fraud" in fiscal year 2023, though it does not state whether this was discovered before or after the fraudulent amounts were paid by IRS.[6] Efiling has allowed IRS to close six service centers, leaving only three. Rather than reducing costs, it has largely converted variable labor into fixed computer hardware and software as the filing and account services budget continues to grow.

In recent years, largely unpublicized court rulings have confirmed harsh results for taxpayers who thought they had properly efiled.

By law, a signed paper return received by IRS is deemed timely filed by the postmark date.[7] A return containing information sufficient for IRS to calculate the proper tax is valid.[8] Neither protection fully applies to efiling. Signing Form 8879 authorizing your preparer to efile is no protection because a return actually efiled is not officially "filed" until the IRS acknowledges its filing.[9]

Should the tax preparer, through negligence or fraud, fail to efile the return (or fail to notice that he received no IRS acceptance acknowledgment), the courts have held that reliance on a preparer is no excuse. The taxpayer is responsible for failure to file penalties. The court suggested that taxpayers seeking to avoid the risk of a negligent or fraudulent agent can file on paper, which would no longer be an option under Commissioner Werfel's $400,000 mandatory efiling proposal.[10]

Failure to include an IP–PIN issued by IRS will cause rejection of an efiled return but not a paper return.[11] A trivial technicality like entering a social security num-

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[3] "Tax Administration: Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risks," GAO–09–297 (Feb. 2009), at 10–12.

[4] "National Taxpayer Advocate delivers Annual Report to Congress; focuses on taxpayer impact of paper processing delays," IR–2024–07, 10 Jan. 2024, *https://www.irs.gov/newsroom/national-taxpayer-advocate-delivers-annual-report-to-congress-focuses-on-taxpayer-impact-of-paper-processing-delays.*

[5] "2011 Annual Report to Congress, vol. 1" National Taxpayer Advocate, p. 62–63, *https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/IRS-TAS-ARC-2011-VOL-1.pdf.*

[6] "IRS Criminal Investigation targets tax fraudsters, urges taxpayers to protect themselves this tax season," Internal Revenue Service, 29 Jan. 2024, *https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-targets-tax-fraudsters-urges-taxpayers-to-protect-themselves-this-tax-season.*

[7] Internal Revenue Code Sec. 7502.

[8] *Beard,* 82 T.C. 766 (1984), aff'd 793 F.2d 139 (CA–6, 1986). A taxpayer filing constitutes a return if (1) it purports to be a return and provides sufficient data to calculate tax liability, (2) the taxpayer made an honest and reasonable attempt to satisfy the requirements of the tax law, and (3) the taxpayer executed the document under penalties of perjury (signature requirement).

[9] IRS Pub. 1345. p. 7.

[10] *Lee v. U.S.,* No 22–10793 (CA–11, 2023), aff'g No. 8:21–cv–01579 (DC M.D. FL, 2022), *https://cases.justia.com/federal/appellate-courts/ca11/22-10793/22-10793-2023-10-24.pdf.* "[T]axpayers can confirm independently with the IRS on the phone . . . [or] choose to file the return independently on paper." CA–11 at p. 23.

[11] Fowler, 155 T.C. No. 7 (2020), citing Beard, *see* FN5 above. "[R]espondent does not explain why the IRS automatically rejects an efiled return, but not a paper return, without a correct IP PIN."

ber on a line designated for an employer ID number can result in rejection of an efiled return, but not a paper return.[12] Failure to file penalties may apply.

Considering how efiling is not as forgiving as paper filing, the best and safest strategy for the average taxpayer seems to be to file by paper. Unlike efiling, paper returns won't be rejected for failure to check a box.

EFILING FAILURES

While efiling is widely used and appears popular, it is in fact often not voluntary. Efiling is mandated for every tax-exempt organization, preparers who file 10 or more returns, and any business filing 10 or more returns (each W–2, 1099, and payroll return counts toward the 10).[13]

Over 95 percent of taxpayers now efile, so IRS no longer handles as much paper.[14] In the past, IRS smoothly processed 100 million paper 1040s annually. Today, it has difficulty handling under 9 million paper returns.

The IRS website lists over 2,700 different forms (including foreign language versions). IRS imposes this mountain of complex forms on taxpayers who risk hacking of their most sensitive data, as occurred at TaxSlayer,[15] or online services like H&R Block, TaxAct, and TaxSlayer sharing data with Facebook.[16] Paper filing is safe from hacking and data-sharing brokers.

Further, efiling services can go down at critical times. H&R Block was down for about 18 hours on April 15, 2024, affecting thousands of last minute filers.[17] Malware brought down Wolters Kluwer's CCH cloud services in May 2019 necessitating IRS granting a week's extension for affected customers' business tax filings.[18] It is unlikely that IRS would consider the same relief for a small tax firm affected by malware, computer failure, or electrical outage.

The IRS itself experiences failures and occasional service outages, including Tax Day, April 18, 2022 [19] and Tax Day, April 17, 2018 filing day outages, among others in 2016 and 2014.[20] These caused serious alarm and frustration among many taxpayers and professionals dealing with last minute filings. Such failures provide compelling evidence that paper filing should always be an option.

DIRECT FILE

I applaud Senator Elizabeth Warren's efforts toward instituting the IRS Direct File program, though not the execution of the program by IRS. I have long supported

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[12] *Hayes v. U.S.,* No. 17–50816 (CA–5, 2019) aff'g No. 3:16–cv–00112 (DC W. TX, 2017). [John William Dunbar, El Paso, Texas, *https://www.sbngcpa.com,* (915) 544–6770, John (Jay) Dunbar jay@dunbar-cpa.com [CA–5 remanded to DC]], *https://cases.justia.com/federal/appellate-courts/ca5/17-50816/17-50816-2019-01-29.pdf.*

[13] Reg. 301.6011–3 (partnerships); Reg. 301.6011–5 (corporations).

[14] Commissioner Rettig, "The Fiscal Year 2023 Budget Request from the U.S. Internal Revenue Service," Senate Financial Services and General Government Subcommittee Hearing, 3 May 2022, *https://www.appropriations.senate.gov/hearings/the-fiscal-year-2023-budget-request-from-the-u-s-internal-revenue-service* at 51:20.

[15] "FTC Gives Final Approval to Settlement with Online Tax Preparation Service," 8 Nov. 2017, *https://www.ftc.gov/news-events/news/press-releases/2017/11/ftc-gives-final-approval-settlement-online-tax-preparation-service.*

[16] "Tax Filing Websites Have Been Sending Users' Financial Information to Facebook," The Markup, 22 Nov. 2022, *https://themarkup.org/pixel-hunt/2022/11/22/tax-filing-websites-have-been-sending-users-financial-information-to-facebook;* "Schiff Urges Investigation Into Disclosure of Taxpayers' Personal, Financial Information to Facebook," Press Release, 2 Feb. 2023, *https://schiff.house.gov/news/press-releases/schiff-urges-investigation-into-disclosure-of-taxpayers-personal-financial-information-to-facebook.*

[17] Ashlea Ebeling, "H&R Block's Tax Day Outage Frustrates Last-Minute Filers," 15 April 2024, *https://www.wsj.com/personal-finance/taxes/hr-block-outage-tax-day-2024-16789a21.*

[18] Daniel Hood, "IRS gives extensions for returns hit by CCH outage," AccountingToday, 12 May 2019, *https://www.accountingtoday.com/news/irs-approves-extensions-for-returns-hit-by-cch-outage.*

[19] "Tax Day 2022: IRS website experiences major slowdown," FoxBusiness, 18 April 2022, *https://www.foxbusiness.com/personal-finance/tax-day-2022-irs-website-experiences-major-slowdown.*

[20] "Review of the System Failure That Led to the Tax Day Outage," Treasury Inspector General for Tax Administration September 19, 2018, Ref. No. 2018–20–065, *https://www.tigta.gov/sites/default/files/reports/2022-02/201820065fr.pdf;* "IRS computer problems shut down e-file system," USA Today, February 3, 2016; There was also an infamous shutdown of the Modernized e-File (MeF) System from October 11, 2014 afternoon through Tuesday, October 14th morning for system maintenance, just before the final October 15th filing deadline. It was compared to Macy's closing for inventory count from December 21st to December 24th.

direct filing and preferably a pre-populated return filing system [21] together with increased funding for IRS.

IRS already has all the relevant W–2 and 1099 information and could mail pre-populated returns to certain taxpayers for signature. Taxpayers often want to file a return as soon as they receive their W–2, so they can receive a refund. Saving tax preparation fees could be a big incentive to waiting for their IRS pre-populated return before filing. Or, IRS could incorporate pre-populated data into Direct File. IRS often issues refunds on good faith, before it has full income and withholding information from the Social Security Administration and 1099 filers, which in the past was not before May. In many countries, tax refunds are not issued until after the official filing date, which minimizes fraud.

The Inflation Reduction Act included a $15-million authorization for a Direct File study. Enacted in August 2022, it resulted in two reports.[22] One by a nonprofit that claimed to have received no compensation and another by IRS. I inquired of Senate staff in September 2023 on how much of the $15 million remained and was advised that it was all spent. It is unfortunate that no one asked Commissioner Werfel where the $15 million went as it surely wasn't required to secure one free and one internal report.

IRS Direct File is a free program for simple tax returns filed on the IRS website.[23] There is a code provision allowing the simplest returns to file a paper tax return and elect for IRS to calculate the tax due.[24]

The Direct File pilot cost far more than justified, and served far fewer taxpayers than studies contemplated. It was too expensive to be considered a success. I hope it will be a resounding success in the future at greatly lower and efficient cost. The benchmark should be that the per return cost to IRS should not exceed the lowest charged by private companies for efiling.

The two studies projected that program costs would range from $5–$15 per federal only return (depending on whether there are 25 million or 5 million filers).[25] With a tentatively reported cost of about $100 million, the pilot program achieved only 100,000 returns at a cost approaching $1,000 per return. Even if the cost was nowhere near $100 million, as Commissioner Werfel protested at the hearing, a $15 million cost would still be $150 per simple tax return.

ID.me

Registering with third-party *ID.me* [26] is a prerequisite to obtaining an IRS online account or using the new IRS Direct File tax program. *ID.me* is a private contractor that Congress has expressed serious reservations about.[27] Senate Finance Committee Chair Ron Wyden has complained, "The infrastructure that powers digital identity, particularly when used to access government websites, should be run by the government."[28] IRS is a "supernet"[29] registered through Homeland Security and hosted by CloudFare which is perhaps the most secure web host.[30]

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[21] "Automatic Tax Filing: Simulating a Pre-Populated Form 1040," National Bureau of Economic Research, Working Paper 30008, April 2022, Revised May 2023, *https://www.nber.org/papers/w30008.*

[22] "IRS-run Direct e-File Tax Return System," May 16, 2023, IRS Pub. 5788. "MITRE Taxpayer Filing Preference Surveys," May 3, 2023, *https://www.mitre.org/news-insights/publication/mitre-taxpayer-filing-preference-surveys.*

[23] IRS Pub. 5917.

[24] IRC §6014. Should probably be repealed as the 1969 limit of $10,000 gross income has never been adjusted for inflation and IRS has not exercised its authorization to raise the income limit.

[25] "IRS-run Direct e-File Tax Return System," 16 May 2023, IRS Pub. 5788, p. 69.

[26] Laura Saunders, "They're Your IRS Records. Getting Them Means Giving Up Privacy," *Wall Street Journal,* 29 April 2022, *https://www.wsj.com/articles/getting-irs-records-from-id-me-means-giving-up-privacy-11651189687.*

[27] Letter to Mr. Blake Hall, Chief Executive Officer, *ID.me*, 14 April 2022, House Committee on Oversight and Reform and Select Subcommittee on the Coronavirus Crisis, *https://oversightdemocrats.house.gov/letters.*

[28] "Wyden Calls on IRS to End Use of Facial Recognition for Online Accounts," 7 Feb. 2022, *https://www.finance.senate.gov/chairmans-news/wyden-calls-on-irs-to-end-use-of-facial-recognition-for-online-accounts.*

[29] IRS has been assigned internet IP range 152.216.0.0–152.225.255.255 (CIDRs 152.216.0.0/13, 152.224.0.0/15). IRS is much bigger than Google's 209.85.128.0–209.85.255.255 (CIDR 209.85.128.0/17).

[30] CloudFare advertises, "Introducing CloudFlare Registrar: Designed for Security, Not the Masses." *https://blog.cloudflare.com/introducing-cloudflare-registrar/.*

ID.me is registered with GoDaddy, a retail web host.[31] I get lots of email from spammers registered with GoDaddy, but have never received any hosted by CloudFare. I do not suggest that *ID.me* is insecure; only that *IRS.gov* appears far more secure than *ID.me*.

ID.me's privacy policy is 5,400 words plus a 6,000 word term of service that few read nor understand, but everyone must check the box that they accept.[32] Over 20% of users are unsuccessful registering with *ID.me*.[33] I advise clients not to use *ID.me* because it's another private database of personal information over which the user lacks control and must trust not to get hacked or sold "anonymized" (*i.e.,* sanitized of personally identifiable information). Direct File has just forced another 100,000 users into *ID.me*'s private database.

Login.Gov, operated by the U.S. General Services Administration, appears would be a superior IRS partner, also registered through Homeland Security and hosted by CloudFare. It is far more transparent, disclosing that it stores login credentials on Amazon Web Services servers, a cloud service. It is currently available for very limited use between taxpayers and IRS. Commissioner Charles Rettig referred to *ID.me* as a "short-term solution is in place for this year's [2022] filing season." The apparent limitation was *Login.Gov*'s inability to handle the massive volume generated from IRS access, which Commissioner Rettig said would be ready to replace *ID.me* in late 2022.[34]

Congress should press IRS into replacing *ID.me* with *Login.Gov*. IRS has more personal information on taxpayers than any other government agency or commercial database, so it should be easier for a taxpayer to verify his identity than submitting a passport or driver's license to a private contractor. Why must it be so much harder and intrusive to access one's IRS account online than with a bank or brokerage account?

CHALLENGE TO EFILING

It can be treacherous to challenge IRS with it's push toward universal efiling. Three months after I wrote a 2012 *Tax Notes* article, "The Case Against Efiling,"[35] I received an IRS notice that I had been selected for a random research audit.

Research audits are extremely rare but intensely time consuming and intrusive. There were only 1,500 research audits in 2012. The IRS agent who audited me was at my premises for 3 days poring over every receipt and disbursement, finding no change in my returns. I have handled two other research audits for clients with seven figure incomes, and I'm nowhere near that threshold. I can only consider that this was a "random" revenge audit.

Administration critics James Comey and Andrew McCabe, former high ranking FBI officials, were also subject to research audits. The furor that theirs were revenge audits precipitated an investigation that examined an inadequate judgment sample size of only 20 out of a population of 10,900 returns using seed numbers[36] that the Treasury Inspector General for Tax Administration complained created a risk that "the seed numbers used could have ensured that specific taxpayers from the original

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[31] GoDaddy commercial webhosting ranges from $60 to as much as $250 per month. CloudFare starts at $200 and up.

[32] *https://www.id.me/privacy; www.id.me/terms.*

[33] "IRS leader explains why the IRS went to *ID.me*," NextGov/FCW, 4 May 2022, *https://www.nextgov.com/digital-government/2022/05/irs-leader-explains-why-irs-went-idme/366516;* "2003 Annual Report to Congress," National Taxpayer Advocate, 98, *https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2024/01/ARC-2023_FullBook_FINAL.pdf;* "Despite privacy concerns, *ID.me* nearly doubled the number of people able to create an IRS account," *Washington Post,* 25 Feb. 2022, *https://www.washingtonpost.com/business/2022/02/25/irs-idme-account-success-rate/*.

[34] "Written Testimony of Charles P. Rettig, Commissioner Internal Revenue Service before the House Ways and Means Committee, Subcommittee on Oversight on the Filing Season and IRS Operations," 17 March 2022, *https://www.irs.gov/newsroom/written-testimony-of-charles-p-rettig-commissioner-internal-revenue-service-before-the-house-ways-and-means-committee-subcommittee-on-oversight-on-the-filing-season-and-irs-operations.*

[35] Jay Starkman, "The Case Against E-Filing," *Tax Notes Federal,* 16 July 2012, *https://www.taxnotes.com/tax-notes-federal/return-preparation/case-against-e-filing/2012/07/16/qr0g.*

[36] The seed is a starting point of random number generator and the same seed always produces the same random number.

sample remained in the subsamples."[37] In other words, the TIGTA investigation proved nothing.

I have published three other articles on efiling, including best practices for safely efiling.[38] I have also published articles promoting tax simplification"[39] and many others promoting good tax policy.

Despite my acquaintances with top IRS officials, my name appearing in several places for the same honors, being known by IRS Media Relations, and having been audited by IRS, I am unable to obtain an EFIN that would allow me to efile. Even with an EFIN, my office computers run Linux exclusively and commercial tax software will not install or run in Linux.

MANDATING EFILING IS BAD TAX POLICY

I would have to tell half my clients, most elderly, whose returns I have been preparing for over 40 years, that they would need to find a new accountant if Congress mandates efiling income tax returns showing $400,000 or more gross income.

Mandated efiling places the start of tax filing at the mercy of IRS. Commissioner Werfel's assertion at the beginning of his hearing testimony that "the 2024 Tax Season opened *on schedule* on January 29th" is questionable. IRS did not announce until January 8th that it would begin accepting efiled returns before that date.[40] Last year, opening day was January 23rd.[41]

Neither date was suitable for many filers, like me, as I mail all my individual and business returns with paper on January 2nd every year. As a practicing CPA, efiling would put me weeks behind schedule because commercial tax software is not ready until close to the "official" start date, and sometimes, not until later because late-released forms have not yet been incorporated into their products.

Finally, and perhaps most important: the private sector knows, it should be as easy as possible to communicate with a business in the customer's preferred method. Especially when it comes to taxes, as we have no alternative to IRS to deal with.

I respectfully urge Congress to reject more efiling mandates because it is bad tax policy. It may help IRS, but it's bad for taxpayers.

Thank you very much for taking the time to consider my comments on this very important issue.

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[37] "National Research Program Tax Return Selection Process for Tax Years 2017 and 2019," Treasury Inspector General for Tax Administration, Report Number: 2023–IE–R002, 29 Nov. 2022, *https://www.tigta.gov/sites/default/files/reports/2022-12/2023ieR002fr.pdf.*

[38] "Beware of E-Filing Your Tax Return," *Wall Street Journal,* 5 Feb. 2024, *https://www.wsj.com/articles/beware-of-e-filing-your-tax-return-legal-trouble-for-error-privacy-risk-cyberattack-96d31111;* "Practice safe efiling," *Journal of Accountancy,* January 2013, *https://www.journalofaccountancy.com/Issues/2013/Jan/20126243.html;* " E-Filing and the Explosion in Tax-Return Fraud," *Wall Street Journal,* 13 Jan. 2013, *https://online.wsj.com/article/SB10001424127887323374504578222130665022160.html.*

[39] "Why Are Taxes So Complex?" *Tax Notes Federal,* 18 Sep. 2017, *https://www.taxnotes.com/tax-notes-today-federal/net-investment-income-tax/why-are-taxes-so-complex/2017/09/18/1w85l;* "Taxation for Prosperity," *Tax Notes Federal,* 13 Feb. 2012, *https://www.taxnotes.com/tax-notes-federal/alternative-minimum-tax/taxation-prosperity/2012/02/13/qpy7;* "Prelude to Tax Simplification," *Journal of Accountancy,* May 1990.

[40] IR–2024–04, January 8, 2024.

[41] IR–2023–05, January 12, 2023.