

**HEARING BEFORE THE
COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES AND
GENERAL GOVERNMENT
UNITED STATES SENATE**

“Review of the President’s Fiscal Year 2014 Funding Request and Budget Justification for the Department of the Treasury and the Internal Revenue Service”



**Testimony of
The Honorable J. Russell George
Treasury Inspector General for Tax Administration**

May 8, 2013

Washington, D.C.

TESTIMONY OF
THE HONORABLE J. RUSSELL GEORGE
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
before the
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Chairman Lautenberg, Ranking Member Johanns, and Members of the Subcommittee, thank you for the opportunity to testify on the Internal Revenue Service’s (IRS) Fiscal Year (FY)¹ 2014 budget request, our recent work related to the most significant challenges currently facing the IRS, and the Treasury Inspector General for Tax Administration’s (TIGTA) FY 2014 budget request.

TIGTA is a nationwide organization. We are statutorily mandated to provide independent audit, investigative, and inspection and evaluation services necessary to improve the quality and credibility of IRS operations, including the oversight of the IRS Chief Counsel and the IRS Oversight Board. TIGTA’s oversight activities are explicitly designed to identify high-risk systemic inefficiencies in IRS operations and to investigate weaknesses in tax administration. TIGTA’s role is critical to providing America’s taxpayers with assurance that the approximately 99,300² IRS employees who collect over \$2.1 trillion in tax revenue each year, process over 147 million individual tax returns, and issue \$333 billion in tax refunds, do so in an effective and efficient manner while minimizing the risks of waste, fraud, and abuse.

TIGTA’s Office of Audit (OA) reviews all aspects of the IRS tax administration system and provides recommendations to: Improve IRS systems and operations, ensure the fair and equitable treatment of taxpayers, and prevent and detect waste, fraud, and abuse. OA places audit emphasis on high-risk areas, statutory mandates, as well as areas of concern to Congress, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other key stakeholders. These reviews have covered such significant issues as identity theft, refund fraud, improper payments, security

¹ The Federal Government’s fiscal year begins on October 1 and ends on September 30.

² Total IRS staffing as of March 23, 2013.

vulnerabilities, complex modernized computer systems, tax collections and revenue, and waste and abuse in IRS operations.

TIGTA's Office of Investigations (OI) protects the integrity of the IRS by investigating allegations of IRS employee misconduct, external threats to employees and facilities, and attempts to impede or otherwise interfere with the IRS's ability to collect taxes. Misconduct by IRS employees manifests itself in many ways, including extortion, theft, taxpayer abuses, false statements, financial fraud, and identity theft.

TIGTA OI has the unique statutory responsibility to protect the IRS by identifying, investigating, and responding to threats against IRS employees located in over 670 IRS facilities located nationwide. Threats and assaults directed at IRS employees, facilities, and critical infrastructure impede the effective administration of the Federal tax system. Contact with the IRS at times can be stressful for taxpayers, and over the last several years, taxpayers have become more confrontational and on occasion violent, when they interact with the IRS.

The threat environment confronting the IRS is significant. Over the past three fiscal years, TIGTA has processed over 8,600 threat-related complaints that resulted in over 4,000 investigations. These investigations resulted in 67 criminal prosecutions and identification of 2,800 people as potentially harmful to IRS employees. Two examples include a taxpayer who flew an airplane into a building that contained an IRS office in 2010 and the three individuals arrested in Atlanta in 2011 for conspiring to blow up Federal facilities, including IRS offices.

TIGTA will continue to place a priority on ensuring the safety and security of IRS employees and facilities. We will review and respond to intelligence information relating to potential violent acts against IRS employees and facilities and develop proactive leads to investigate and mitigate potential threats. In addition, investigators will respond to violent acts committed against IRS employees and facilities and will work towards the arrest, conviction, and sentencing of the perpetrators.

OVERVIEW OF THE IRS'S FY 2014 BUDGET REQUEST

The IRS is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. The IRS's budget request supports the Department of the Treasury's goals to pursue comprehensive tax and fiscal reform and to manage the Government's finances in a fiscally responsible manner. The IRS supports these goals through its strategies of increasing voluntary tax

compliance and increasing the number of electronic transactions with the public. The IRS strives to enforce the tax laws fairly and efficiently while balancing service and education to promote voluntary compliance and reduce taxpayer burden. The IRS's role is unique within the Federal Government in that it collects the revenue that funds the Government and administers the Nation's tax laws. It also works to protect Federal revenue by detecting and preventing the growing risk of fraudulent tax refunds and other improper payments.

To achieve these goals, the proposed FY 2014 IRS budget requests appropriated resources of approximately \$12.9 billion.³ The total appropriations amount is an increase of slightly more than \$1 billion, or approximately nine percent more than the FY 2012 enacted level of approximately \$11.8 billion. This increase is illustrated in Table 1. The budget request includes a net staffing increase of 4,572 full-time equivalents (FTE)⁴ for a total of approximately 96,200 appropriated FTEs. The IRS is operating under a Continuing Resolution⁵ for FY 2013; however, this funding was reduced by \$618 million as a result of the sequestration⁶ and rescission.⁷

³ The FY 2014 budget request also includes approximately \$111 million from reimbursable programs, \$278 million from user fees, \$114 million in available multi-year/no-year funds, and a transfer out to the Alcohol and Tobacco Tax and Trade Bureau of \$5 million for a total amount of \$13.4 billion in available resources. Multi-year funds are made available for a specific time period of more than one fiscal year. No-year funds do not have a specific time period that the funds must be spent by and are available until the objectives of the program have been achieved.

⁴ A full-time employee working 40 hours per week for 52 weeks.

⁵ A continuing resolution provides temporary funding for the period of time specified in the continuing resolution.

⁶ Sequestration involves automatic spending cuts of approximately \$1 trillion across the Federal Government that took effect on March 1, 2013.

⁷ A rescission cancels part of an agency's discretionary budget authority and is usually established as a percentage reduction to the budget authority.

TABLE 1

**IRS FY 2014 Budget Request Increase
Over FY 2012 Enacted Budget
(in Thousands)**

Appropriations Account	FY 2012 Enacted	FY 2014 Request	\$ Change	% Change
Taxpayer Services	\$2,239,703	\$2,412,756	\$172,873	7.72%
Enforcement	\$5,299,367	\$5,666,787	\$367,420	6.93%
Operations Support	\$3,947,416	\$4,480,843	\$533,427	13.51%
Business Systems Modernization	\$330,210	\$300,827	\$(29,383)	-8.90%
Total Appropriated Resources	\$11,816,696	\$12,861,033	\$1,044,337	8.84%

Source: TIGTA analysis of IRS's FY 2014 Budget Request, Operating Level Tables.

The three largest appropriation accounts are Taxpayer Services, Enforcement, and Operations Support. The Taxpayer Services account provides funding for programs that focus on helping taxpayers understand and meet their tax obligations, while the Enforcement account supports the IRS's examination and collection efforts. The Operations Support account provides funding for functions that are essential to the overall operation of the IRS, such as infrastructure and information services. Finally, the Business Systems Modernization account provides funding for the development of new tax administration systems and investments in electronic filing.

Funding Related to Implementing the ACA Provisions

The Patient Protection and Affordable Care Act of 2010⁸ and the Health Care and Education Reconciliation Act of 2010 that made amendments to it (collectively referred to as the "ACA") contains an extensive array of tax law changes that will present many challenges for the IRS in the coming years. The ACA provisions provide incentives and tax breaks to individuals and small businesses to offset health care expenses. They also impose penalties, administered through the tax code, for individuals and businesses that do not obtain health care coverage for themselves or their employees.

⁸ Pub. L. No. 111-148, 124 Stat. 119, 2010 (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

While the Department of Health and Human Services (HHS) will take the lead in developing the policy provisions of the Act, the IRS will administer the law's numerous tax provisions. The IRS estimates that the ACA includes approximately 50 tax provisions, at least eight of which will require the IRS to build new computer applications and business processes that do not exist within the current tax administration system.

In June 2012, we reported that appropriate plans had been developed to implement tax-related provisions of the ACA using well-established methods for implementing tax legislation. The IRS's plans addressed tax forms, instructions, and most of the affected publications, as well as employee training, outreach and guidance to taxpayers and preparers, computer programming, and the compilation of additional data to enforce compliance with various ACA provisions.

In FY 2012, the IRS received \$299 million from the Health Insurance Reform Implementation Fund (HIRIF) to support an additional 664 FTEs. The HIRIF is administered by the Department of Health and Human Services as provided for in the Health Care and Education Reconciliation Act of 2010 to carry out the ACA. This was in addition to the funding received by the IRS based on its enacted budget.

The IRS informed TIGTA that it does not anticipate receiving any funding from the HIRIF after FY 2012. The IRS also informed TIGTA that its FY 2013 spending plan includes \$360 million to implement the ACA in FY 2013. Since the IRS will not be reimbursed from the HIRIF for 2013, all FY 2013 ACA spending is funded from the IRS's operating budget.

The IRS's FY 2014 budget request includes additional funding of \$440 million to provide 1,954 FTEs for continued efforts related to the implementation of the ACA. The largest component of this increase is \$306 million for the implementation of the information technology changes needed to deliver tax credits and other requirements.

The development and implementation of new systems for the ACA provisions present major information technology management challenges. These include rapid implementation of interdependent projects that require extensive coordination within the IRS and with other Federal agencies. For example, one new system is the Income and Family Size Verification project, which uses tax return data to verify household income and family size for each person applying for health care coverage. TIGTA found that

the IRS was generally managing system risks and made recommendations to improve the system development process.⁹

One key health care provision takes effect December 31, 2013. This provision is the requirement for individuals to maintain minimum essential health care coverage¹⁰ or face a continuous penalty. Starting in Calendar Year 2014, the IRS will be responsible for implementing the Premium Assistance Tax Credit¹¹ as well as implementing the penalty on applicable individuals for each month they fail to have minimum essential coverage. These two issues have a far-reaching impact on the IRS, and will require significant resources, particularly customer service resources, as taxpayers turn to the IRS with questions and issues about the ACA and their tax and health insurance requirements. Customer service has been declining in recent years, with fewer taxpayers being served at the local offices and the IRS answering fewer telephone calls. The ACA will further stretch these already limited resources at the IRS.

SELECTED SIGNIFICANT ISSUES FACING THE IRS

As requested by the Subcommittee, in this section of my testimony, I will examine several of the most significant challenges now facing the IRS as it administers the Nation's tax laws.

IRS TAX GAP

A serious challenge confronting the IRS is the Tax Gap, which is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a Tax Year (TY). The most recent gross Tax Gap estimate developed by the IRS was \$450 billion for TY 2006. In comparison, the gross Tax Gap was estimated at \$345 billion for TY 2001. The \$450 billion Tax Gap estimate for 2006 is the best approximation of noncompliance the IRS can provide. However, it is important to note that because of the methods that are used, a significant portion of the Tax Gap is inferred. The voluntary compliance rate¹² decreased slightly from 83.7

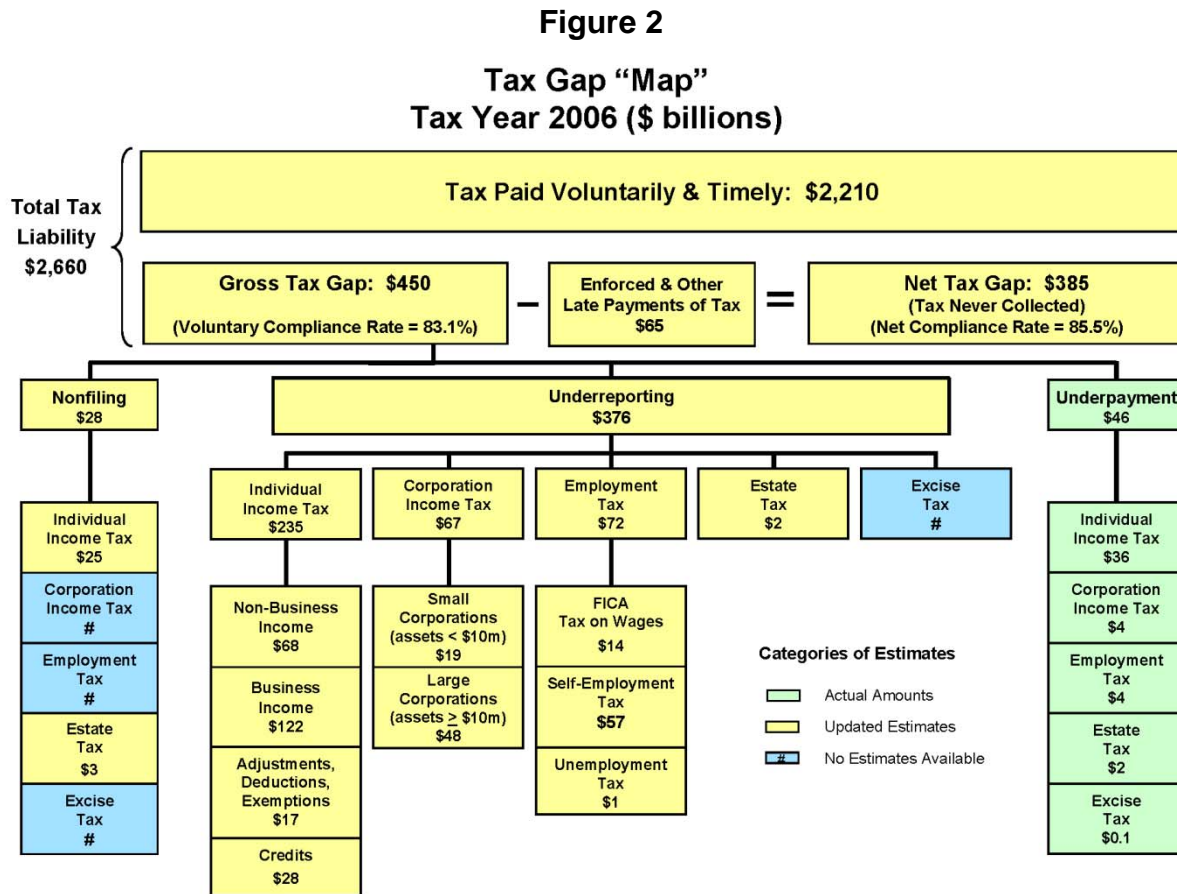
⁹ TIGTA, Ref. No. 2013-23-034, *Affordable Care Act: The Income and Family Size Verification Project Is Applying a New Iterative Systems Development Process* (Mar. 2013).

¹⁰ The type of coverage an individual needs to have to meet the individual responsibility requirement under the Affordable Care Act.

¹¹ The Premium Assistance Tax Credit provides a refundable tax credit that eligible taxpayers can use to help cover the cost of health insurance premiums for individuals and families who purchase health insurance through a State health benefit exchange.

¹² The voluntary compliance rate is the amount of true tax liability imposed by law for a given tax year that is paid voluntarily and timely by the taxpayer.

percent in 2001 to 83.1 percent in 2006. Figure 2 shows the IRS’s latest Tax Gap Map illustrating the various components of the Tax Gap.



Internal Revenue Service, December 2011

Reducing the Tax Gap is an IRS priority. For example, in September 2006, the Treasury Department’s Office of Tax Policy published “A Comprehensive Strategy for Reducing the Tax Gap.” The 2006 report provided a seven-component strategy for reducing the Tax Gap. The components of that strategy are to:

1. reduce opportunities for evasion;
2. make a multi-year commitment to research;
3. continue improvements in information technology;
4. improve compliance activities;
5. enhance taxpayer service;
6. reform and simplify the tax law; and
7. coordinate with partners and stakeholders.

In July 2009, the Treasury Department completed a report on the Tax Gap that identified detailed strategic priorities, compliance program accomplishments, planned actions and legislative proposals.¹³ Notwithstanding this well-laid plan, reducing the Tax Gap and improving voluntary compliance is an ongoing challenge that requires a multi-faceted approach.

More recently, the Government Accountability Office issued its Tax Gap report,¹⁴ stating that because noncompliance has multiple causes and spans different types of taxes and taxpayers, multiple approaches are needed to reduce the Tax Gap.

TIGTA has also identified several concerns with both estimating the Tax Gap and efforts to reduce it. For example, while the IRS has not developed an estimate for the international portion¹⁵ of the Federal Tax Gap, non-IRS estimates of the international Tax Gap range from \$40 billion to \$123 billion.¹⁶ Another concern about the IRS's methods to estimate the size of the Tax Gap is that the various sample sizes used in the employment tax study may be insufficient to determine compliance levels.¹⁷

The following strategies could help improve tax compliance:

- **Information Reporting.** Enhancing information reporting by third parties to the IRS could reduce tax evasion and help taxpayers comply voluntarily. However, identifying additional reporting opportunities can be challenging because third parties may not have accurate information that is readily available. Also, adding reporting requirements creates a burden for both third parties and the IRS.

The IRS has developed a strategy and vision to explore more “real time” or upfront matching of tax returns when they are first filed with the IRS instead of the traditional “look back” model of compliance. If the tax return contains information that does not match the IRS’s records, the IRS could provide the taxpayer the opportunity to fix his or her tax return before it is accepted. It would

¹³ The Department of the Treasury, “Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance.” July 2009. Available at http://www.irs.gov/pub/newsroom/tax_gap_report_-_final_version.pdf.

¹⁴ Government Accountability Office, Ref. No. GAO 12-651T, *Tax Gap: Sources of Noncompliance and Strategies to Reduce It* (Apr. 2012).

¹⁵ The international Tax Gap is defined as taxes owed—but not collected on time—from a U.S. person or foreign person whose cross-border transactions are subject to U.S. taxation.

¹⁶ TIGTA, Ref. No. 2009-IE-R001, *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap* (Jan. 2009).

¹⁷ TIGTA, Ref. No. 2011-10-034, *Limitations in the Sample Size for the Internal Revenue Service’s Employment Tax Study May Impact Ability to Determine Compliance Levels* (May 2010).

also enable the IRS to identify and prevent a significant number of fraudulent refund claims based on false W-2 data.

- **Taxpayer Service.** Ensuring high-quality services to taxpayers, such as by telephone and correspondence or online, can help encourage those taxpayers who wish to comply with tax laws but do not understand their tax obligations. However, tax law changes and funding priorities have recently affected the IRS's ability to provide quality taxpayer services.

TIGTA reported that taxpayers are increasing their use of customer assistance tools; however, budget cuts and staffing shortages prevented the IRS from properly meeting its Level of Service¹⁸ goals for FY 2012. As a result, taxpayers waited longer on the IRS's toll-free telephone assistance lines. In addition, tax return preparation was provided only on a limited number of days per week and only on a first-come, first-served basis at Taxpayer Assistance Centers.¹⁹

- **Enforcement.** Devoting additional resources to enforcement could enable the IRS to contact the millions of potentially noncompliant taxpayers it identifies but cannot contact due to resource limitations. To determine the appropriate level of enforcement resources, policymakers would need to consider how to balance taxpayer service and enforcement activities and how effectively and efficiently the IRS currently uses its resources. We reviewed enforcement revenue trends and noted that in FY 2007, the IRS collected over \$59 billion in taxes, penalties and interest, but the dollars collected dropped over the next two years before increasing again in FY 2010. Subsequently, dollars collected decreased to slightly more than \$50 billion in FY 2012. While the IRS did not track the reason for the increase in FY 2010, the IRS did receive additional funds to hire over 1,500 revenue officers from June 2009 to February 2010.

IRS statistics show that 50 percent of the partnership returns²⁰ audited after being selected by the Discriminant Index Function (DIF) system,²¹ or related to a

¹⁸ The IRS's Level of Service measure reflects the percentage of taxpayers who call for live assistance on the Customer Service's toll-free telephone lines and speak with an assistor.

¹⁹ TIGTA, Ref. No. 2012-40-119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sep. 2012).

²⁰ Form 1065, *U.S. Return of Partnership Income*, is an information return used to report the income, gains, losses, deductions, credits, etc., from the operation of a partnership. A partnership does not pay tax on its income but "passes through" any profits or losses to its partners.

²¹ The DIF system uses computer formulas to classify tax returns for examination potential by assigning weights to certain basic tax return characteristics and scoring the tax return. The higher the score, the higher the probability of significant tax change as a result of the examination.

DIF-selected return, were closed as a no-change in FY 2011. The IRS has relied on this system to decide how to best allocate its audit resources. According to the IRS, a high no-change rate means the IRS is spending a significant amount of resources on unproductive audits and compliant taxpayers are unnecessarily burdened by audits. TIGTA reported that the IRS should pursue alternative audit selection techniques by using existing databases containing partnership data to help identify additional productive returns for audit.²²

The IRS approach to International Tax Administration includes an initiative to identify and develop baselines and measures to better assess the international Tax Gap and progress in reducing it. The Foreign Account Tax Compliance Act (FATCA) is an important development in U.S. efforts to improve tax compliance involving foreign financial assets and offshore accounts. The changes required by the FATCA will combat tax evasion by U.S. persons holding investments in offshore accounts, expand the IRS global presence, and pursue international tax and financial crimes. Prior to the enactment of the FATCA, the IRS did not have a system to detect offshore tax evasion. The IRS's development of a new FATCA system is a major Information Technology investment for the IRS and is critical for the IRS to ensure international tax compliance. TIGTA plans to review the development of this critical system and the operation of FATCA once implemented.

- **Compliance Checks.** Expanding compliance checks before the IRS issues refunds would involve matching information returns to tax returns during, rather than after, the tax filing season. This approach would require a major reworking of some fundamental IRS computer systems but could help address identity theft-related fraud and allow the IRS to use enforcement resources on other compliance problems.

TIGTA reported that the IRS took a number of additional steps for the 2012 Filing Season²³ to detect identity theft tax refund fraud before it occurred.²⁴ These efforts included designing new identity theft screening filters²⁵ that the IRS indicates will improve its ability to identify false tax returns before the tax return is

²² TIGTA, Ref. No. 2012-30-06, *Despite Some Favorable Partnership Audit Trends, the Number of No-Change Audits Is a Concern* (June 2012).

²³ The period from January through mid-April when most individual income tax returns are filed.

²⁴ TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

²⁵ Computer programs designed to detect fraud and improve the IRS's ability to spot false returns before they are processed and refunds are issued.

processed and before a fraudulent tax refund is issued. In addition, beginning in Processing Year²⁶ 2012 the filters use benefit and withholding information from the Social Security Administration (SSA). This information is used to verify that Social Security benefits and related withholding reported on tax returns match the information reported by the SSA. The IRS reports that it identified and confirmed identity theft on over 31,000 tax returns claiming fraudulent Social Security benefits and withholding, and stopped approximately \$169 million in fraudulent tax refunds in Processing Year 2012 using the information provided by SSA. The IRS advised us that for the 2013 Filing Season, the filters have been refined and incorporate criteria based on the latest characteristics of confirmed identity theft tax returns.

- **External Parties.** Leveraging external resources, such as paid tax return preparers and whistleblowers, can help improve tax compliance because paid preparers' actions have an enormous impact on the IRS's ability to effectively administer tax laws. In addition, whistleblowers provide the IRS with information on suspected noncompliance.

TIGTA has reported on the IRS's efforts to improve oversight of the return preparer community.²⁷ While the IRS began implementing the new preparer requirements in FY 2011, TIGTA reported that it will take years for the IRS to implement the Return Preparer Program, including establishing all of the program requirements and developing the systems and processes necessary to administer and oversee the program. However, this program is on hold based on a recent court ruling. On January 18, 2013, the United States District Court for the District of Columbia ruled that the IRS did not have the authority to regulate tax preparers who had not been regulated before—namely preparers who were not certified public accountants, attorneys, enrolled agents, or enrolled actuaries.²⁸ On January 23, 2013, the IRS filed a motion to suspend the injunction pending appeal. The U.S. District Court for the District of Columbia denied the IRS's motion but clarified that the IRS is not required to suspend the Preparer Tax Identification Number (PTIN) program, which is one aspect of the Return Preparer Program.²⁹ The IRS filed a notice of appeal to the District of Columbia Circuit Court on February 20, 2013.

²⁶ The calendar year in which the tax return or document is processed by the IRS.

²⁷ TIGTA, Ref. No. 2010-40-127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (Sep. 2010).

²⁸ *Loving v. IRS*, 2013 U.S. Dist. LEXIS 7980 (D.D.C. Jan. 18, 2013).

²⁹ *Loving v. IRS*, 2013 U.S. Dist. LEXIS 13878 (D.D.C. Feb. 1, 2013).

The IRS Whistleblower Program also plays an important role in reducing the Tax Gap and maintaining the integrity of a voluntary tax compliance system. However, TIGTA reported that the program continued to have internal control weaknesses on the processing of whistleblower claims. For example, information captured from multiple systems and entered into a single inventory control system was potentially inaccurate, and the quality review process for the new inventory system was not sufficient to ensure that claims were accurately controlled. Additionally, TIGTA determined that timeliness standards for processing claims were not sufficient. Without adequate oversight of the Whistleblower Program, the IRS is not as effective as it could be in responding timely to tax noncompliance issues.³⁰

- **Modernization.** Modernizing information systems could potentially allow the IRS to post more comprehensive tax return information to its computer systems, which could facilitate the examination process and expedite taxpayer contacts for faster resolution.

The IRS considers the Customer Account Data Engine 2 (CADE 2) program critical to the IRS's mission and it is the IRS's most important information technology investment. TIGTA reported that the implementation of CADE 2 daily processing allowed the IRS to process tax returns for individual taxpayers more quickly by replacing existing weekly processing.³¹ The CADE 2 system also provides for a centralized database of individual taxpayer accounts, which will allow IRS employees to view tax data online and provide timely responses to the taxpayers once it is implemented. The IRS's modernization efforts also include the development of computer programs to conduct predictive analytics to reduce refund fraud.³² The successful implementation of the IRS's modernization program should significantly improve service to taxpayers and enhance Federal tax administration.

- **Simplifying tax return requirements.** Simplifying the tax code could help taxpayers understand and voluntarily comply with their tax obligations and limit opportunities for tax evasion.

³⁰ TIGTA, Ref. No. 2012-30-045, *Improved Oversight Is Needed to Effectively Process Whistleblower Claims* (Apr. 2012).

³¹ TIGTA, Ref. No. 2012-20-122, *Customer Account Data Engine 2 System Requirements and Testing Processes Need Improvements* (Sep. 2012).

³² Computer models that analyze extremely large quantities of data to seek out data patterns and relationships that could indicate potential tax fraud schemes.

- **Penalties.** Congress provided numerous penalty provisions in the Internal Revenue Code that the IRS can use to help remedy the noncompliance that contributes to the Tax Gap. The IRS can assess accuracy-related penalties for negligence, substantial understatement of income tax, or substantial valuation misstatement. The IRS estimated that the underreporting of tax contributed \$376 billion (84 percent) of the \$450 billion total gross Tax Gap, including \$235 billion from individual income taxes. To deter this type of behavior, the IRS reported that it assessed over 500,000 accuracy-related penalties, involving over \$1 billion against individuals during FY 2011.

Penalties are an important tool because they discourage taxpayer behavior that contributes to the Tax Gap. However, the numerous reports TIGTA has issued suggest that the IRS could take better advantage of these tools to deter noncompliance.

For example, TIGTA reported that additional steps must be taken to ensure that examiners properly consider and assess accuracy-related penalties when taxpayers are negligent or understate their tax liabilities by \$5,000 or more.³³ A review of 229 audits conducted through the mail found 211 instances (92 percent) where applicable penalties were not considered and assessed. Each of the audits resulted in the taxpayer agreeing they owed additional taxes of at least \$5,000. The \$5,000 threshold is important because examiners are required to consider assessing an accuracy-related penalty. Since the penalties were not considered and assessed, TIGTA believes opportunities may have been missed to promote compliance among an estimated 9,255 taxpayers over a five-year period, and to enhance penalty and interest revenue by an estimated \$17.5 million.

In another example, TIGTA made several recommendations to help ensure that taxpayers receive fair and consistent treatment by improving how the IRS administered a penalty under Internal Revenue Code Section 6707A.³⁴ This penalty could be assessed against taxpayers for failing to disclose participation in certain reportable transactions and was enacted to detect, deter, and shut down abusive tax shelter activity. Its importance to the IRS's efforts in combating abusive tax shelters was reflected in the severity of the penalty. The penalty

³³ TIGTA, Ref. No. 2010-30-059, *Accuracy-Related Penalties Are Seldom Considered Properly During Correspondence Audits* (June 2010).

³⁴ TIGTA, Ref. No. 2011-30-004, *Penalty Cases for Failure to Disclose Reportable Transactions Were Not Always Fully Developed* (Dec. 2010).

could be as high as \$100,000 for individuals and \$200,000 for businesses if they fail to disclose participation in specific transactions that the IRS has identified and listed in publications as abusive.

Finally, TIGTA reported that actions could be taken to reinforce the importance of recognizing and investigating fraud indicators during field audits.³⁵ TIGTA reviewed 116 audits of sole proprietors³⁶ in which the taxpayer agreed they owed additional taxes of at least \$10,000 and found 26 audits with fraud indicators that were not recognized or investigated. As a result, TIGTA believes sole proprietors in some 1,872 audits avoided approximately \$19.7 million (\$98 million over five years) in civil fraud penalties that may have been owed. The fact that fraud indicators were not recognized and investigated in nearly one out of every four of these large-dollar cases is a concern because the omitted income and overstated deductions were substantial.

IDENTITY THEFT AND TAX REFUND FRAUD

Identity Theft

Incidents of identity theft affecting tax administration have continued to rise since Calendar Year (CY) 2011, when the IRS identified more than one million incidents of identity theft that impacted our Nation's tax system. As of December 31, 2012, the IRS identified almost 1.8 million incidents during CY 2012. This figure includes approximately 280,000 incidents in which taxpayers contacted the IRS alleging that they were victims of identity theft,³⁷ and more than 1.5 million incidents in which the IRS detected potential identity theft.³⁸

In July 2012, TIGTA reported that the impact of identity theft on tax administration is significantly greater than the amount the IRS detects and prevents.³⁹ Using the characteristics of confirmed identity theft and data that becomes available later in the year, we analyzed TY 2010 tax returns processed during the 2011 Filing Season and identified 1.5 million undetected tax returns with potentially fraudulent tax refunds totaling in excess of \$5 billion. If not addressed, we estimate that the IRS could

³⁵ TIGTA, Ref. No. 2012-30-030, *Actions Can Be Taken to Reinforce the Importance of Recognizing and Investigating Fraud Indicators During Field Audits* (Mar. 2012).

³⁶ A sole proprietor is someone who owns an unincorporated business by himself or herself.

³⁷ Taxpayers can be affected by more than one incident of identity theft. The 280,000 incidents affected 233,365 taxpayers.

³⁸ These 1.5 million incidents affected 985,843 taxpayers.

³⁹ TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

issue approximately \$21 billion in fraudulent tax refunds resulting from identity theft over the next five years.

As a result of the delayed start of this year's filing season, we were unable to determine the extent of identity theft cases this year or compare trends with last year's filing season during our interim filing season audit. However, it is highly likely that incidents of identity theft will show a continued increase when the current filing season results are reported.

Although the IRS is working towards finding ways to determine which tax returns are legitimate, access to third-party income and withholding information at the time tax returns are processed is the single most important tool the IRS could use to detect and prevent identity theft tax fraud resulting from the reporting of false income and withholding. Third-party reporting information would enable the IRS to identify the income as false and prevent the issuance of a fraudulent tax refund. However, most of this information is not available until well after tax return filing begins.⁴⁰

Another important tool that could immediately help the IRS prevent tax fraud-related identity theft is the National Directory of New Hires.⁴¹ However, legislation is needed to expand the IRS's authority to access the National Directory of New Hires wage information for use in identifying tax fraud. Currently, the IRS's use of this information is limited by law to just those tax returns that include a claim for the Earned Income Tax Credit.⁴² The IRS included a request for expanded access to this information in its annual budget submissions for FY 2010 through 2013, and has once again included this request in its FY 2014 budget submission.

One promising development occurred at the end of March 2013, when the IRS announced it was expanding a program designed to help law enforcement obtain tax return data for their investigations and prosecutions of specific cases of identity theft. The IRS initiated this program to assist local law enforcement with arrests and prosecutions related to identity theft. Under a pilot program, which was started in April 2012 in the State of Florida, State and local law enforcement officials who have evidence of identity theft involving fraudulently filed tax returns were able, through a written disclosure consent waiver from the victim, to obtain tax returns filed using the

⁴⁰ Form W-2, *Wage and Tax Statement*, is an information return containing wage and withholding information for taxpayers. Employers were required to file Forms W-2 to the IRS for the 2012 tax year by April 1, 2013.

⁴¹ A Department of Health and Human Services national database of wage and employment information submitted by Federal agencies and State workforce agencies.

⁴² A tax credit for certain people who work and have earned income under \$50,270.

victim's SSN. The pilot was expanded in October 2012 to eight additional States. There was widespread use of this program. Under the pilot, more than 1,560 waiver requests were received by the IRS from over 100 State and local law enforcement agencies in the nine States participating in the pilot. On March 29, 2013, the pilot was expanded to a permanent program that was effective for all 50 States and the District of Columbia.

Even with improved identification of tax returns that report false wage and withholding information, verifying whether the returns are fraudulent will require resources. Using IRS estimates, it would cost approximately \$32 million to screen and verify the approximately 1.5 million tax returns that we identified as not having third-party information, which indicates that the return information could be false.

The IRS is developing a new Return Review Program system to implement its emerging business model for a coordinated approach for prevention, detection, and resolution of pre-refund tax fraud. This system will replace the IRS's current fraud detection system, the Electronic Fraud Detection System, which was implemented in 1994. The Return Review Program system is critical for the IRS's success in dealing with tax schemes, and will evaluate tax returns against the prior three years' filing history and other external data sources. The first two phases of implementation for the Return Review Program will occur in the 2014 and 2015 filing seasons.

Regarding assistance to identity theft victims, TIGTA reported that the IRS is not effectively providing assistance to taxpayers who report that they have been victims of identity theft, resulting in increased burden for those victims.⁴³ Moreover, identity theft cases can take more than one year to resolve and communication between the IRS and victims is limited and confusing. Victims are also asked multiple times to substantiate their identities.

In addition, the management information system that telephone assistors use to control and work cases can add to the taxpayer's burden. For instance, the IRS may open multiple cases for the same victim, and multiple assistors may work that same victim's identity theft issue. A review of 17 taxpayers' identity theft cases showed that 58 different cases involving those taxpayers had been opened, and multiple assistors had worked their cases. Our audit also found that victims become further frustrated when they are asked numerous times to prove their identities, even though they have

⁴³ TIGTA, Ref. No. 2012-40-050, *Most Taxpayers Whose Identities Have Been Stolen to Commit Refund Fraud Do Not Receive Quality Customer Service* (May 2012).

previously followed IRS instructions and sent in Identity Theft Affidavits⁴⁴ and copies of their identification with their tax returns. We also found in May 2012⁴⁵ that the IRS sends the victims duplicate letters at different times, wasting agency resources and possibly confusing the victims.

The growth of identity theft presents considerable challenges to tax administration. In CY 2011, the IRS reported that over 641,000 taxpayers were victims of identity theft. This figure includes taxpayers who contacted the IRS alleging that they were victims. In CY 2012, the IRS identified an additional 1.2 million of these taxpayers.

In FY 2012, the IRS dedicated 400 additional employees to the Accounts Management function⁴⁶ to work identity theft cases. As a result, the function now has approximately 2,000 employees working these cases. However, its inventory of identity theft cases has grown almost 50 percent from FY 2011 to 2012. As of March 9, 2013, the Accounts Management function reported that it had over 249,000 identity theft cases in its inventory.

Criminal Investigations of Identity Theft

Identity theft not only has a negative impact on the economy, but the damage it causes to its victims can be personally, professionally, and financially devastating. When individuals steal identities and file false tax returns to obtain fraudulent refunds before the legitimate taxpayers file, the crime is simple tax fraud, which falls within the programmatic responsibility of IRS Criminal Investigation. TIGTA's Office of Investigations focuses its resources on investigating identity theft that has any type of IRS employee involvement, the misuse of client information by tax preparers, or the impersonation of the IRS through phishing⁴⁷ schemes and other means.

For example, a former IRS employee was arrested after being charged by a Federal grand jury on June 26, 2012, for aggravated identity theft, mail fraud, unauthorized inspection of tax returns and return information, and unauthorized disclosure of tax returns and return information. She subsequently pled guilty to those

⁴⁴ IRS Form 14039, *Identity Theft Affidavit*.

⁴⁵ TIGTA, Ref. No. 2012-40-050, *Most Taxpayers Whose Identities Have Been Stolen to Commit Refund Fraud Do Not Receive Quality Customer Service* (May 2012).

⁴⁶ The function that works the majority of identity theft cases involving individual duplicate tax returns.

⁴⁷ Phishing is an attempt by an individual or group to solicit personal and financial information from unsuspecting users in an electronic communication by masquerading as trustworthy entities such as government agencies, popular social websites, auction sites, online payment processors, or information technology administrators.

charges on August 14, 2012, and was sentenced on March 28, 2013, to 28 months of imprisonment with three years of supervised release.⁴⁸

TIGTA also investigated a tax preparer who stole the personal identifiers of several individuals and unlawfully disclosed the information to others to fraudulently obtain tax refunds. According to the indictment, the subject of the investigation worked as a tax preparer from January 2002 to June 2008. In 2010, he used the personal identifiers of other individuals to file false income tax returns and obtain refunds from the IRS. The preparer obtained most of the personal identifiers in the course of his prior employment as a tax preparer and from other employment positions he held. He disclosed this information to co-conspirators so they could also file false income tax returns and obtain refunds from the IRS. The subject and his co-conspirators ultimately defrauded or attempted to defraud the IRS out of at least \$560,000 in tax refunds.⁴⁹

As a third example, TIGTA investigated a phishing scheme in which several individuals were deceived into divulging their personal identifiers and banking information to identity thieves who then defrauded them of over \$1 million. The subject and his co-conspirators operated a scheme to defraud numerous individuals through Internet solicitations and stealing the identities of those individuals. The subject of the investigation was sentenced to a total of 30 months of imprisonment and five years of supervised release for aggravated identity theft and conspiracy to commit wire fraud. He was also ordered to pay \$1,741,822 in restitution to his victims.⁵⁰

While phishing schemes may vary in their technical complexity, most share a common trait: They involve computers located outside the United States. Despite the significant investigative challenge this poses, TIGTA has been successful in working with law enforcement personnel in foreign countries to identify the perpetrators and obtain prosecutions.

Identity thieves may also commit identity theft by impersonating IRS employees or misusing the IRS seal to induce unsuspecting taxpayers to disclose their personal identifiers and financial information. One such criminal posed as an IRS “Audit Group Representative” and, according to the indictment, sent letters to various employers demanding that they send him the names, contact information, dates of birth, and SSNs of their employees. He then prepared and filed false Federal tax returns in the names

⁴⁸ E.D. Pa. Arrest Warrant executed July 5, 2012; E.D. Pa. Crim. Indict. filed June 26, 2012; E.D. Pa. Crim. Docket dated Jan. 22, 2013.

⁴⁹ S.D. Cal. Superseding Indict. filed June 19, 2012.

⁵⁰ E.D.N.Y. Response to Defendant’s Sentencing Letter filed Dec. 19, 2011; E.D.N.Y. Judgment filed Aug. 9, 2012.

of the employees without their knowledge or consent. The tax returns contained W-2⁵¹ information, such as income and withholding, that was falsely and fraudulently inflated. The subject of the investigation used the refunds to purchase personal items. The subject pled guilty to false impersonation of an officer and employee of the United States; identity theft; subscribing to false and fraudulent U.S. individual income tax returns; and false, fictitious, or fraudulent claims. He was sentenced to 41 months of imprisonment and three years of supervised release. He was also ordered to pay \$8,716 in restitution.⁵²

Refundable Credits

The IRS administers numerous refundable tax credits.⁵³ The most significant refundable credit is the Earned Income Tax Credit (EITC). Two other refundable credits include the Additional Child Tax Credit (ACTC) and the American Opportunity Tax Credit (AOTC).⁵⁴ For several years, TIGTA has reported significant concerns with the growth in noncompliance and fraud in refundable tax credits.⁵⁵

The EITC remains the largest refundable credit based on the total claims paid, and it continues to be vulnerable to a high rate of noncompliance, including incorrect or erroneous claims caused by taxpayer error or resulting from fraud. TIGTA continues to report that the IRS does not have effective processes to ensure that claimants qualify for these credits at the time tax returns are processed and prior to issuance of fraudulent tax refunds. The IRS estimates that it has paid between \$110 billion and \$133 billion in improper EITC payments from FYs 2003 through 2012.⁵⁶ It does not track estimates for the other refundable credits.⁵⁷

The IRS has made little improvement in reducing EITC improper payments in the years since it was required to report estimates of these payments to Congress in CY

⁵¹ Form W-2, *Wage and Tax Statement*.

⁵² S.D.N.Y. Crim. Indict. filed Jan. 25, 2012; S.D.N.Y. Minute Entry filed July 11, 2012; S.D.N.Y. Judgment filed March 25, 2013.

⁵³ A refundable tax credit is a tax credit that is treated as a payment and can be refunded to the taxpayer. Refundable credits can create a Federal tax refund that is larger than the amount a person actually paid in taxes during the year.

⁵⁴ Other refundable credits claimed by a small number of taxpayers include the Health Coverage Tax Credit, the Fuel Tax Credit, and the Credit for Prior Year Minimum Tax.

⁵⁵ TIGTA, Ref. No. 2012-40-105, *Expansion of Controls Over Refundable Credits Could Help Reduce the Billions of Dollars of Improperly Paid Claims* (Sep. 2012).

⁵⁶ Department of the Treasury Performance and Accountability Reports for FYs 2003 through 2010 and the Agency Financial Report for FYs 2011 and 2012, as outlined in Office of Management and Budget Circular No. A-136.

⁵⁷ TIGTA, Ref. No. 2013-40-024, *The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012* (Feb. 2013).

2002. The rate of improper EITC payments has remained high and there continues to be a risk that no significant improvement will be made in reducing EITC improper payments. The IRS estimates that the EITC improper payment rate was 21 – 25 percent in FY 2012, which equates to \$12 billion to \$14 billion.

TIGTA further reported that although Executive Order 13520⁵⁸ requires the IRS to intensify its efforts to reduce EITC improper payments, reduction targets and strategies have not been established to reduce the billions of dollars associated with these payments.⁵⁹ For example, the Executive Order requires the IRS to provide TIGTA with its plans and supporting analysis for meeting those targets. The IRS's report to TIGTA did not include any quantifiable targets to reduce EITC improper payments. IRS management noted that it did not set reduction targets because it must balance enforcement efforts among different taxpayer income levels.

The Additional Child Tax Credit is also susceptible to improper claims. However, the IRS did not identify the ACTC as a high-risk program under the Improper Payments Elimination and Recovery Act of 2010 (IPERA).⁶⁰ Agencies are not required to take any further action to assess or quantify improper payments if a high risk for improper payments does not exist. As a result, the IRS and the Department of the Treasury are not required to quantify and report on ACTC improper payments. Nevertheless, TIGTA found that taxpayers repeatedly claimed erroneous ACTCs after their claims were disallowed the previous year.⁶¹ The IRS could have saved more than \$108 million by reviewing claims made by taxpayers who were previously disallowed the credit. TIGTA has reported that the IRS's risk process does not provide a reliable assessment of the risk of improper payments in the IRS's revenue program funds.⁶² In addition, TIGTA found that the IRS is not in compliance with all IPERA requirements reported to the Department of the Treasury.⁶³

TIGTA also found that when the IRS freezes and reviews a questionable EITC claim but releases a related ACTC, the ACTC will later be disallowed 67 percent of the time, and the IRS will have to employ post-refund collection methods to recover the

⁵⁸ *Reducing Improper Payments and Eliminating Waste in Federal Programs*, November 23, 2009.

⁵⁹ TIGTA, Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year* (Feb. 2011).

⁶⁰ Pub. L. 111-204, 124 Stat. 2224. 2010.

⁶¹ TIGTA, Ref. No. 2012-40-105, *Expansion of Controls Over Refundable Credits Could Help Reduce the Billions of Dollars of Improperly Paid Claims* (Sep. 2012).

⁶² TIGTA, Ref. No. 2013-40-015, *Improper Payments Elimination and Recovery Act Risk Assessments of Revenue Programs are Unreliable* (Jan. 2013).

⁶³ TIGTA, Ref. No. 2013-40-024, *The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012* (Feb. 2013).

credits. Erroneous credits discovered after refunds are released may require more costly enforcement actions, and the likelihood of collection diminishes over time. The IRS could have prevented approximately \$419 million in erroneous ACTC refunds from being released had it reviewed the ACTC at the same time the EITC was being reviewed.

In September 2011, we reported that as of May 28, 2010, 2.1 million taxpayers received \$3.2 billion in education credits such as the AOTC that appeared to be erroneous.⁶⁴ Another TIGTA audit found that individuals were claiming education tax credits for students who, based on age, are unlikely to be pursuing an undergraduate degree or vocational certification.⁶⁵

We notified the IRS on January 5, 2012 that we had identified approximately 35,000 individuals who were younger than the typical age of individuals enrolled in a four-year college degree program or vocational school certificate program who were claimed for the AOTC. It appeared that the individuals were used to erroneously claim the AOTC on TY 2009 returns. Of the 35,000 individuals, 13,870 were age 10 and younger. TIGTA's additional review identified more than 109,000 taxpayers who as of May 2, 2012, received refundable AOTC for TY 2011 totaling more than \$159 million for students whose age made them unlikely to be enrolled in a four-year college degree program or vocational certification.

TAXPAYER SERVICE

As demand for taxpayer services continues to increase, resources have decreased, thereby affecting the quality of customer service that the IRS is able to provide. Despite other available options, most taxpayers continue to use the telephone as the primary method to make contact with the IRS. In addition, more taxpayers are calling the IRS's toll-free telephone lines each year. In September 2012, TIGTA reported that an increase in call demand and limited resources continue to adversely affect the IRS's Level of Service for its toll-free telephone lines.⁶⁶ During the 2012 Filing Season, taxpayers made over 90 million attempts to call the various Customer Account

⁶⁴ TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sep. 2011).

⁶⁵ TIGTA, Ref. No. 2012-40-119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sep. 2012).

⁶⁶ TIGTA, Ref. No. 2012-40-119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sep. 2012).

Services function toll-free telephone assistance lines⁶⁷ seeking help in understanding the tax law and meeting their tax obligations.⁶⁸ IRS assistors answered over 13 million calls and achieved approximately a 68 percent Level of Service and a 946-second (almost 16 minutes) Average Speed of Answer.⁶⁹

A reduction in funding for toll-free telephone and correspondence services resulted in a Level of Service for FY 2012 of 67 percent. The IRS plans to provide a 70 percent Level of Service for the 2013 Filing Season as well as for FY 2013. As of March 9, 2013, approximately 56.5 million taxpayers contacted the IRS by calling the various customer service toll-free telephone assistance lines seeking help in understanding the tax law and meeting their tax obligations. IRS assistors have answered 8.3 million calls and have achieved a 67.8 percent Level of Service with a 14.2 minute Average Speed of Answer. This decrease in the Level of Service translates to longer customer wait times, an increased number of customers abandoning calls, and an increased number of customers redialing the IRS toll-free telephone lines for service. The last year the IRS provided a Level of Service of more than 80 percent was FY 2007.

From the 2007 to the 2012 Filing Season, the IRS's ability to process taxpayer correspondence in a timely manner also declined. Assistors who answer the toll-free telephone lines also handle taxpayer correspondence (including processing amended tax returns and identity theft cases). During the filing season when call demand is usually at its highest, more resources are shifted to the telephones to answer calls, and correspondence inventory processing is placed on hold until call demand subsides. As call volumes have increased and assistors have been moved to answer telephone calls, paper correspondence inventories have substantially increased. The correspondence inventory rose from approximately 480,000 at the end of FY 2007 to more than 1 million at the end of FY 2012, representing an increase of nearly 114 percent.

Each year, many taxpayers also seek assistance from one of the IRS's 397 walk-in offices, called Taxpayer Assistance Centers. The IRS assisted almost 7 million taxpayers in FY 2012 and plans to assist 6 million taxpayers during FY 2013, 15 percent fewer than in FY 2012. The FY 2013 plan was based on the assumption of

⁶⁷ The IRS refers to the suite of 29 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

⁶⁸ Toll-free telephone assistance data were taken from available IRS reports through the week ending April 21, 2012.

⁶⁹ The average amount of time for an assistor to answer the call after the call is routed to a call center staff.

limited seasonal staff support and continuing reduction of permanent staff as a result of the hiring freeze.

As a result, during the 2013 Filing Season, the IRS again provided tax return preparation on a limited number of days per week and only on a first-come, first-served basis. The IRS will not offer taxpayers the option to leave a message when they call local Taxpayer Assistance Center telephone lines. Appointments will not be available. Instead, the IRS offers alternative services for tax return preparation, such as Volunteer Income Tax Assistance, Free File, and Fillable Forms. The IRS has indicated that service provided to taxpayers and the amount of money collected through enforcement activities could decline as a result of the budget cuts of the last few years.

HUMAN CAPITAL

Continued focus by IRS executive management on human capital will remain important because the IRS is facing several key challenges. In addition to a workforce that shrunk by approximately 10,000 employees between the end of FY 2010 and the end of FY 2012, IRS data show that more than one-third of all executives and almost 20 percent of non-executive managers are currently eligible for retirement. In addition, the IRS reported FTEs were further reduced in FY 2013. Within five fiscal years, nearly 70 percent of all IRS executives and nearly one-half of the IRS's non-executive managers are projected to be eligible for retirement. Overall, about 40 percent of the IRS's employees will be retirement eligible within five fiscal years.

In the current budget environment, the IRS will also be challenged to continue some of the human capital work it has started. For example, the IRS is undergoing a change in top leadership. Commissioner Douglas Shulman left the IRS when his term expired in November 2012. During Commissioner Shulman's term, he formed the Workforce of Tomorrow Task Force to address the IRS's most serious workforce issues, and much progress was made on human capital issues during his tenure. Interim leadership and the next Commissioner will need to ensure that actions are taken to build on the momentum gained during Commissioner Shulman's term and to effectively address human capital challenges.

TIGTA BUDGET REQUEST FOR FY 2014

As requested by the Subcommittee, I will now provide information on our budget request for FY 2014.

TIGTA's FY 2014 President's Budget Request is \$149,538,000, a decrease of 1.42 percent below the FY 2012 enacted budget. These reductions were a result of savings TIGTA achieved by increasing efficiency, streamlining operations, and reducing costs such as travel, training, communications/utilities, and operations/maintenance of equipment, as well as a hiring freeze for the remainder of the FY and do not include the sequestration reductions. While these budget cuts impact existing programs and reflect the tough choices that the Nation continues to face, TIGTA will continue to focus on its mission of ensuring an effective and efficient tax administration system in this lean budget environment. The FY 2014 budget resources include funding to support TIGTA's critical audit, investigative, and inspection and evaluation priorities, while still maintaining a culture that continually seeks to identify opportunities to achieve efficiencies and cost savings. During the period April 1, 2012 through March 31, 2013, TIGTA's combined audit and investigative efforts have recovered, protected, and identified⁷⁰ monetary benefits totaling \$23.6 billion, including cost savings, increased revenue, revenue protection,⁷¹ and court-ordered settlements in criminal investigations.

TIGTA's FY 2014 budget request proposes eliminating certain reviews required by the IRS Restructuring and Reform Act of 1998,⁷² which add little value to mission achievement. Eliminating these statutory reporting requirements will allow TIGTA to reinvest resources to conduct higher priority audits.

IRS Implementation of the ACA

Several key ACA provisions will become effective in FY 2014, therefore making FY 2014 a significant year for ACA oversight. Many provisions that previously became effective will require continued oversight to ensure that appropriate corrective actions are taken by the IRS. TIGTA's oversight requires close coordination among the Audit,

⁷⁰ Dollars potentially compromised by bribery; dollar amount of tax liability for taxpayers who threaten and/or assault IRS employees; dollar value of IRS and resources protected against malicious loss; dollar amount of embezzlement or taxpayer remittance theft; dollar value of Government property recovered; dollar value of court ordered criminal and civil penalties, fines, and restitution; and dollar value of seizures, forfeitures, and recoveries from contract fraud.

⁷¹ Recommendations made by TIGTA to prevent erroneous refunds or efforts to defraud the tax system.

⁷² Pub. L. No. 105-206, 112 Stat. 685. 1998 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

Investigations, and Inspections and Evaluations functions. Each program office brings unique skills and experience, but TIGTA's overall success depends greatly upon these offices' close collaboration. As such, TIGTA has implemented a multi-year oversight strategy that includes audits, evaluations, and investigative resources to assess and to proactively deter efforts to impede the IRS's implementation of the ACA. This strategy includes coordination with other agencies, including the Department of Health and Human Services Office of Inspector General.

For example, in FY 2013, TIGTA is planning to conduct or initiate 14 ACA-related audits with at least 10 new audits planned for FY 2014. This extensive ACA coverage is stretching TIGTA's Audit resources, especially in light of other audit priorities including requests from the Congress, Treasury, and the IRS and TIGTA's hiring freeze. For TIGTA's investigators, our experience has shown that the IRS's expanded role under the ACA may spark a new wave of animosity directed toward IRS employees. For example, TIGTA has investigated threats made by taxpayers to IRS employees as a result of the IRS offsetting their Federal tax refunds for the repayment of student loans or court-ordered child support payments. TIGTA foresees an increase in the number of threats against IRS employees and facilities as ACA provisions start to take effect, requiring additional resources to be dedicated to investigating these threats.

Shortly after the Supreme Court upheld the constitutionality of the ACA, the media reported that criminals impersonated a Federal agency in an attempt to fraudulently obtain personally identifiable information from unsuspecting taxpayers to further their identity theft schemes and other crimes under the guise that the sensitive information was required for ACA compliance. Based upon our experience investigating this type of criminal activity, TIGTA anticipates a significant increase in the number of ACA-related impersonation attempts as the IRS begins its role in ACA compliance activity.

TIGTA's Audit Priorities

TIGTA's audit priorities include mitigating risks associated with modernization, security over taxpayer data and employees, procurement fraud, addressing the Tax Gap, implementing major tax law changes, and human capital challenges facing the IRS. Recent audit work has uncovered inefficient use of resources at the IRS concerning aircard and BlackBerry® smartphone assignments, shortcomings in the IRS's compliance with the Improper Payments Elimination and Recovery Act, and imperfections in the way the IRS refers and recognizes indications of fraud. In addition, TIGTA has determined that the IRS could develop or improve processes that will

increase its ability to detect and prevent the issuance of fraudulent tax refunds resulting from identity theft.

TIGTA's Investigative Priorities

Over the past several years, in order to be responsive to mission requirements, the Office of Investigations has identified efficiencies and embarked on numerous reorganizations to properly place its assets in a position to address the growing number of threats. Consequently, any future budget reductions for OI will be absorbed primarily through law enforcement staffing. This reduction will also severely hamper OI's ability to effectively investigate its other primary program area, investigating allegations of IRS employee misconduct and wrongdoing. OI will be forced to reduce the number of these investigations that are critical to ensuring the IRS and its employees operate with the utmost integrity, free from internal corruption.

Procurement Fraud

TIGTA's Procurement Fraud group investigates allegations of waste, fraud, and abuse involving IRS procurements and procurement-related misconduct by IRS employees. The Procurement Fraud group is also responsible for promoting fraud awareness within the IRS contracting community. On average, the IRS executes approximately 900 procurements each year worth approximately \$31 billion in total contract value.⁷³ Due to budgetary pressures, the Procurement Fraud group is currently operating at a reduced staffing level. Consequently, TIGTA does not have the investigative resources to proactively identify and address procurement fraud risks in IRS programs. If the Procurement Fraud group was fully staffed, TIGTA could help ensure that the IRS and taxpayers receive full value for the billions of contracting dollars spent. For example, based on its limited staffing, from May 1, 2009 through September 30, 2012, the Procurement Fraud group initiated 44 investigations, resulting in the recovery of over \$112 million. If properly staffed, the number of investigations and the resulting recoveries would increase substantially. A 2012 Association of Certified Fraud Examiners report⁷⁴ estimated that five percent of an organization's revenue is at risk of fraud annually. In the case of the IRS, this estimate is \$1.6 billion.

⁷³ The total dollar value of a contract over the life of the contract.

⁷⁴ Association of Certified Fraud Examiners, "Report to the Nations on Occupational Fraud and Abuse," 2012.

Combating Phishing Schemes

Criminals involved in identity theft schemes use creative ways to obtain victims' personally identifiable information⁷⁵ to commit fraud. Over the past several years, TIGTA has observed an increase in phishing attacks that use the IRS as a lure – from 3,000 phishing sites in 2008 to over 13,000 sites so far this year. Much of the activity is hosted from foreign countries. Phishing,⁷⁶ which usually involves mass solicitation of potential victims through e-mail or other forms of electronic communication, is a widespread method used by criminals to steal another's identity. TIGTA investigators work with IRS personnel to identify and block these phishing sites and have been successful in working with law enforcement personnel in foreign countries to identify the perpetrators and obtain prosecutions.

Criminals often send e-mails claiming to be from the IRS. These phishing e-mails contain a "hook" that induces the victim to take some sort of overt action. The criminals may lead the victims to believe they are due a tax refund from the IRS or they have won the lottery but must first pay a "tax" before they can receive the money. The victims are instructed to provide their personally identifiable information and financial information such as bank account numbers or credit card numbers to the criminals before the refund or lottery winnings can be released.

Some phishing schemes are designed to install malicious code, or "malware," on a victim's computer. The malware is installed when the victim opens an attachment to the phishing e-mail or clicks on a hyperlink in the e-mail. Once installed, the malware can steal information from the victim-computers or use the victim-computers as part of a network of compromised computers which are then used to perpetrate criminal activity.

In addition, TIGTA OI is also implementing two new enforcement initiatives to address critical tax administration issues:

TIGTA is responsible for protecting the integrity of Federal tax administration and the IRS's most valuable asset: Its employees. Over the past several years, our country has experienced numerous violent incidents in schools, private offices, and public

⁷⁵ Personally identifiable information (PII) refers to information that can be used to distinguish or trace an individual's identity, alone or when combined with other personal or identifying information. Examples of PII include: Name, Social Security Number, biometric records, date of birth, financial or bank account information, and driver's license number.

⁷⁶ Phishing is an attempt by an individual or group to solicit personal and financial information from unsuspecting users in an electronic communication by masquerading as trustworthy entities such as government agencies, popular social websites, auction sites, online payment processors, or information technology administrators.

areas. These tragic events are usually unpredictable and result in numerous innocent people losing their lives or being severely injured. Between FY 2009 and 2012, TIGTA has processed over 8,600 threat-related complaints and conducted over 4,000 investigations of threats made against IRS employees. To address the potential danger that one of these active threat incidents would be focused on IRS employees (such as the taxpayer who attempted to commit suicide inside an IRS office in 2007), TIGTA special agents are being trained to respond to and neutralize an active threat which could endanger the lives of the approximately 99,300 IRS employees who are employed in over 670 facilities nationwide.

A large portion of IRS employees are in direct contact with taxpayers and often encounter situations where a taxpayer may challenge the employee's integrity. Bribery, or attempted bribery, of a public official is a serious offense and it is an attack on the integrity of the entire IRS organization. Our voluntary tax compliance system is only successful if taxpayers have confidence that everyone pays their fair share and individuals who attempt to bribe their way out of paying their taxes will be caught and prosecuted. To appropriately respond to this serious crime, TIGTA created a training program for both IRS employees and TIGTA special agents. The purpose of this critical training is two-fold: 1) to raise awareness of bribery overtures to IRS employees and 2) to provide TIGTA special agents with refresher training for conducting bribery investigations. By raising awareness, TIGTA hopes that IRS employees will recognize bribery attempts and promptly report such attempts to TIGTA for investigation.

In this challenging budget environment, we at TIGTA remain committed to delivering our mission of ensuring an effective and efficient tax administration system and preventing, detecting, and deterring waste, fraud, and abuse. We will also identify additional opportunities for cost savings, increased revenue, and revenue protection throughout the IRS. However, with lower budgets, our investigations and audits will be reduced which will result in increased risks of IRS employee integrity lapses, undetected procurement fraud, and the reduced ability to respond to phishing schemes. It will also result in lower identified cost savings and funds put to better use because of fewer audit recommendations to improve control weaknesses and reduced financial recoveries due to fewer successful investigations and prosecutions. TIGTA will be challenged to provide comprehensive coverage to address emerging risks facing the IRS.

I hope my discussion of the IRS budget request and some of the major challenges facing the IRS assists Congress in ensuring accountability over the IRS.

Chairman Lautenberg, Ranking Member Johanns, and Members of the Subcommittee, thank you for the opportunity to share my views.



J. Russell George

Treasury Inspector General for Tax Administration

Following his nomination by President George W. Bush, the United States Senate confirmed J. Russell George in November 2004, as the Treasury Inspector General for Tax Administration. Prior to assuming this role, Mr. George served as the Inspector General of the Corporation for National and Community Service, having been nominated to that position by President Bush and confirmed by the Senate in 2002.

A native of New York City, where he attended public schools, including Brooklyn Technical High School, Mr. George received his Bachelor of Arts degree from Howard University in Washington, DC, and his Doctorate of Jurisprudence from Harvard University's School of Law in Cambridge, MA. After receiving his law degree, he returned to New York and served as a prosecutor in the Queens County District Attorney's Office.

Following his work as a prosecutor, Mr. George joined the Counsel's Office in the White House Office of Management and Budget where he was Assistant General Counsel. In that capacity, he provided legal guidance on issues concerning presidential and executive branch authority. He was next invited to join the White House Staff as the Associate Director for Policy in the Office of National Service. It was there that he implemented the legislation establishing the Commission for National and Community Service, the precursor to the Corporation for National and Community Service. He then returned to New York and practiced law at Kramer, Levin, Naftalis, Nessen, Kamin & Frankel.

In 1995, Mr. George returned to Washington and joined the staff of the Committee on Government Reform and Oversight and served as the Staff Director and Chief Counsel of the Government Management, Information and Technology subcommittee (later renamed the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations), chaired by Representative Stephen Horn. There he directed a staff that conducted over 200 hearings on legislative and oversight issues pertaining to Federal Government management practices, including procurement policies, the disposition of government-controlled information, the performance of chief financial officers and inspectors general, and the Government's use of technology. He continued in that position until his appointment by President Bush in 2002.

In addition to his duties as the Inspector General for Tax Administration, Mr. George serves as a member of the Recovery Accountability and Transparency Board, a non-partisan, non-political agency created by the American Recovery and Reinvestment Act of 2009 to provide unprecedented transparency and to detect and prevent fraud, waste, and mismanagement of Recovery funds. There, he serves as chairman of the Recovery.gov committee, which oversees the dissemination of accurate and timely data about Recovery funds.

Mr. George also serves as a member of the Integrity Committee of the Council of Inspectors General for Integrity and Efficiency (CIGIE). CIGIE is an independent entity within the executive branch statutorily established by the Inspector General Act, as amended, to address integrity, economy, and effectiveness issues that transcend individual Government agencies; and increase the professionalism and effectiveness of personnel by developing policies, standards, and approaches to aid in the establishment of a well-trained and highly skilled workforce in the offices of the Inspectors General. The CIGIE Integrity committee serves as an independent review and investigative mechanism for allegations of wrongdoing brought against Inspectors General.