

**HEARING BEFORE THE
COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES AND
GENERAL GOVERNMENT
U.S. HOUSE OF REPRESENTATIVES**

“Oversight Hearing - Department of Treasury”



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

March 5, 2013

Washington, D.C.

TESTIMONY OF
THE HONORABLE J. RUSSELL GEORGE
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
before the
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Chairman Crenshaw, Ranking Member Serrano, and Members of the Subcommittee, I thank you for the opportunity to testify on our recent work related to the most significant challenges currently facing the Internal Revenue Service (IRS), as well as on the Treasury Inspector General for Tax Administration’s (TIGTA) Fiscal Year (FY)¹ 2013 budget request.

TIGTA is a nationwide organization located in 68 offices throughout the United States and Puerto Rico. 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 exploited weaknesses in tax administration. TIGTA’s role is critical to providing the American taxpayer with assurance that the approximately 92,500 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, or 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 fraud, waste, and abuse. OA places audit emphasis on statutory coverage required by the IRS Restructuring and Reform Act of 1998 (RRA 98),² the American Recovery and

¹ A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government’s fiscal year begins on October 1 and ends on September 30.

² 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.).

Reinvestment Act of 2009,³ and other laws, as well as areas of concern to Congress, the Secretary of the Treasury, the Commissioner of the IRS, and other key stakeholders. These reviews have covered such high-risk issues as identity theft, refund fraud, improper payments, information technology, security 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.

OI places the highest priority on its statutory responsibility to protect approximately 92,500 IRS employees located in over 670 facilities nationwide. In the last three years, threats directed at the IRS have become a larger percentage of OI's work. Physical violence, harassment, and intimidation of IRS employees continue to pose significant challenges to the implementation of a fair and effective system of tax administration. OI is committed to ensuring the safety of IRS employees and the security of IRS facilities.

For FY 2012, TIGTA has recovered, protected, and identified monetary benefits totaling \$22.7 billion, including cost savings, increased revenue, revenue protection, and court-ordered settlements in criminal investigations.

OVERVIEW OF THE STATUS OF THE IRS'S FY 2013 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 increase voluntary tax compliance. 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.

³ Pub. L. No. 111-5, 123 Stat. 115. 2009.

TIGTA has reported on the IRS's efforts to shift resources to work cases of high risk, rapidly growing fraud and abuse.⁴

FY 2014 IRS Budget

As of March 5, 2013, the President had not submitted the IRS's FY 2014 budget to Congress. In addition, the IRS does not have an approved budget for FY 2013 and is operating under a Continuing Resolution with funding based on its FY 2012 enacted budget.

Comparison of FY 2013 Budget to FY 2012 Budget

For FY 2013, the IRS requested appropriated resources of \$12.8 billion. The total appropriations request is an increase of \$945 million, or approximately eight percent more than the FY 2012 enacted level of approximately \$11.8 billion. The budget request includes a net staffing increase of more than 4,500 full-time equivalents (FTE),⁵ to a total of 95,257 appropriated FTEs.

In its FY 2013 budget request, the Administration sought to increase funding over FY 2012 enacted operating levels for three of the appropriations accounts. These increases ranged from one (1) to 13 percent (see Figure 1).

⁴ 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); and TIGTA, Ref. No. 2011-30-118, *The 2009 Offshore Voluntary Disclosure Initiative Increased Taxpayer Compliance, but Some Improvements Are Needed* (Sep. 2011).

⁵ A measure of labor hours in which one FTE is equal to eight hours multiplied by the number of compensable days in a particular fiscal year.

Figure 1

**IRS FY 2013 Budget Request Increase
Over FY 2012 Enacted Budget
(in Thousands)**

| Appropriations Account | FY 2012 Enacted | FY 2013 Request | \$ Change | % Change |
|---|----------------------------|----------------------------|----------------------|---------------------|
| Taxpayer Services ⁶ | \$2,239,703 | \$2,253,133 | \$13,430 | 0.60% |
| Enforcement | \$5,299,367 | \$5,701,670 | \$402,303 | 7.59% |
| Operations Support | \$3,947,416 | \$4,476,200 | \$528,784 | 13.40% |
| Business Systems Modernization | \$330,210 | \$330,210 | \$0 | 0% |
| Total Appropriated Resources | \$11,816,696 | \$12,761,213 | \$944,517 | 7.99% |

Source: TIGTA analysis of IRS's FY 2013 Budget Request, Operating Level Tables.

The three largest appropriations 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.

The Patient Protection and Affordable Care Act of 2010⁷ and the Health Care and Education Reconciliation Act of 2010⁸ that made amendments to it (hereinafter 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. While the Department of Health and Human Services 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 and at least eight will require the IRS

⁶ In FY 2012, administrative resources for the Health Coverage Tax Credit were moved to the Taxpayer Services appropriation under the Consolidated Appropriations Act of 2012 (Public Law 112-74) and are no longer funded as a separate appropriation.

⁷ 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.

⁸ Pub. L. No. 111-152, 124 Stat. 1029. 2010.

to build new computer applications and business processes that do not exist within the current tax administration system.

In FY 2012, the IRS received \$299 million from the Health Insurance Reform Implementation Fund (HIRIF) to fund an additional 667 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 funding was in addition to the funding received by the IRS based on its enacted budget. The IRS's FY 2013 budget request includes no FTEs directly funded by the Department of Health and Human Services. The IRS informed TIGTA that it does not expect any additional funding from the HIRIF.

ACHIEVING PROGRAM EFFICIENCIES AND COST SAVINGS

The IRS FY 2013 budget request also assumes that efficiency savings will result in a net reduction of \$71 million and an associated reduction of 614 FTEs for FY 2013. The three largest areas of cost savings include almost \$60 million in program reductions (a 437 FTE decrease), approximately \$3 million in a reduction of non-technical travel and non-case related travel, and approximately \$9 million in savings from increased electronic filings (a 177 FTE decrease).

As stated earlier, the IRS's FY 2013 Continuing Resolution is based on its FY 2012 enacted budget. However, the FY 2012 budget was reduced over \$300 million from FY 2011. To meet the lower budget in FY 2012, the IRS reduced its administrative costs, accepted early outs and buy outs for more than 1,600 employees, and made difficult decisions in taxpayer service and enforcement operations.

Given the current economic environment and the increased focus by the Administration, Congress, and the American people on Federal Government accountability and efficient use of resources, the American people must be able to trust that their Government is taking action to stop wasteful practices and ensure that every tax dollar is spent wisely.

While the IRS has made progress to improve program effectiveness and reduce costs, TIGTA identified other opportunities for efficiencies and cost savings:

- The IRS can reduce its office space needs by almost 1 million square feet, resulting in potential rental savings of over \$100 million over five years, by establishing a policy requiring employees who telework to share workstations.⁹
- The IRS can improve the efficiency of its servers. Specifically, approximately 650 IRS servers could be candidates for replacement with virtual servers. If the servers are added to the virtual environment and not replaced with new physical servers, the IRS could save approximately \$7.26 million in equipment costs and approximately \$470,000 over five years in electrical cost.¹⁰
- The IRS paid over \$1 million during FY 2011 for 13,878 aircards and 754 BlackBerrys that were not used for periods of three months to one year. Overall, process improvements could result in cost savings totaling approximately \$5.9 million over five years.¹¹
- The IRS was not always fully reimbursed for services it provides to other Federal Government agencies. Specifically, we identified more than \$28 million in costs incurred by the IRS in FY 2011 that were not reimbursed. As a result, the IRS funded this work using its own operating budget, thereby reducing funds available for tax administration.¹²
- The IRS's cybersecurity and privacy governance board did not take actions to manage delays on its workstation security monitoring project. This project was originally supposed to be deployed in December 2010. However, the project experienced delays and the board allowed contractor support services of over \$1 million to be incurred from December 2010 to April 2012. The new deployment date is scheduled for May 2013. The board knew of these delays, but did not postpone the project's activities and use its resources more efficiently.¹³

⁹ TIGTA, Ref. No. 2012-10-100, *Significant Additional Real Estate Cost Savings Can be Achieved by Implementing a Telework Workstation Sharing Strategy* (Aug. 2012).

¹⁰ TIGTA, Ref. No. 2012-20-029, *Virtual Server Technology Has Been Successfully Implemented, but Additional Actions Are Needed to Further Reduce the Number of Servers and Increase Savings* (Mar. 2012).

¹¹ TIGTA, Ref. No. 2013-10-010, *Inadequate Aircard and BlackBerry Assignment and Monitoring Processes Result in Millions of Dollars in Unnecessary Access Fees* (Jan. 2013).

¹² TIGTA, Ref. No. 2012-10-076, *The Full Costs of Work Performed on Reimbursable Agreements Are Not Always Charged, Resulting in Reduced Funds Available for Tax Administration* (July 2012).

¹³ TIGTA, Ref. No. 2013-20-016, *Significant Delays Hindered Efforts to Provide Continuous Monitoring of Security Settings on Computer Workstations* (Jan. 2013).

- The IRS may have erroneously paid almost \$1 million in Recovery Act funding for labor charges to contractors in Calendar Year 2011 without examining supporting documentation.¹⁴
- The IRS inefficiently spent \$1.2 million on a contract to conduct physical security vulnerability assessments at 669 IRS facilities nationwide. IRS management instructed the contractor to perform services that were lesser in scope than required by the original contract and did not provide the contractor access to all of the facilities or information necessary to complete a report outlining the IRS's overall security posture. As a result, an independent risk assessment of facility physical security was not performed in compliance with contract requirements. In fact, the contractor declined to provide a validation of the acceptability of the IRS's security posture at these facilities.¹⁵

SELECTED SIGNIFICANT ISSUES FACING THE IRS

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, as the Subcommittee has requested.

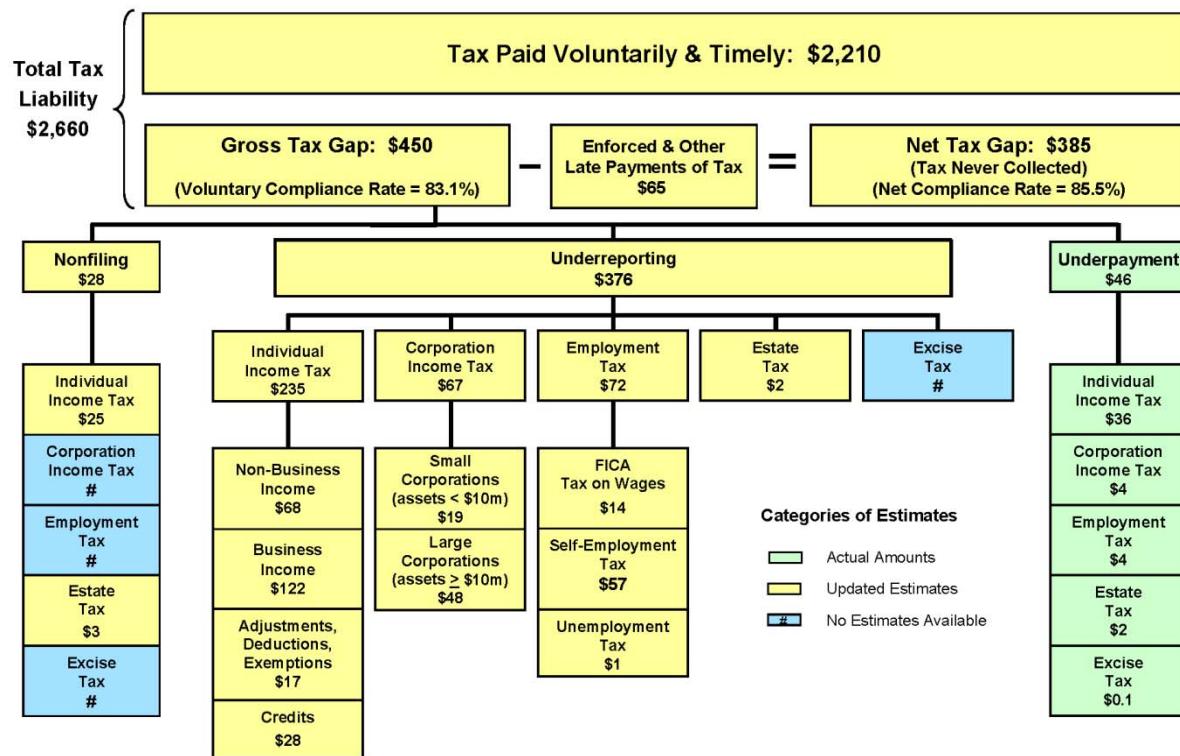
IRS TAX GAP

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 and not observed. The voluntary compliance rate decreased slightly from 83.7 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.

¹⁴ TIGTA, Ref. No. 2012-11-101, *Deficiencies Continue to Exist in Verifying Contractor Labor Charges Prior to Payment* (Sep. 2012).

¹⁵ TIGTA, Ref. No. 2012-10-075, *An Independent Risk Assessment of Facility Physical Security Was Not Performed in Compliance With Contract Requirements* (July 2012).

Figure 2
Tax Gap “Map”
Tax Year 2006 (\$ billions)



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 issued 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.¹⁶ 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,¹⁷ stating that because noncompliance has multiple causes and spans different types of taxes and taxpayers, multiple approaches are needed to reduce the Tax Gap. Using the Government Accountability Office report's framework, the following strategies could help address 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.

TIGTA agrees that access to third-party income and withholding information at the time tax returns are processed would encourage voluntary compliance and would prevent billions of dollars in fraudulent tax refunds. One opportunity to expand information reporting is for the IRS to obtain access to the National Directory of New Hires wage information for tax administration purposes. Currently, the IRS's use of the National Directory of New Hires is limited by law to just those tax returns with the Earned Income Tax Credit. The IRS included a request for expanded access in each of its annual budget submissions for FYs 2010 through 2013.

- **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.

¹⁶ 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.

¹⁷ Government Accountability Office, Ref. No. GAO 12-651T, *Tax Gap: Sources of Noncompliance and Strategies to Reduce It* (Apr. 2012).

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 service 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.¹⁸

- **Enforcement.** Devoting additional resources to enforcement that 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.

TIGTA's analysis of the TY 2010 tax returns processed during the 2011 Filing Season identified that tax fraud by individuals filing fictitious tax returns with false income and withholding is significantly larger than what the IRS detects and prevents. Using characteristics from those tax returns the IRS identified and confirmed as filed by identity thieves, we identified approximately 1.5 million additional undetected tax returns with potentially fraudulent tax refunds totaling in excess of \$5.2 billion. The IRS estimates that it would cost approximately \$32 million to screen and verify these additional tax returns.¹⁹

IRS statistics show that 50 percent of the partnership returns audited after being selected by the Discriminant Index Function (DIF) system,²⁰ or related to a 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.²¹

¹⁸ 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).

¹⁹ TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

²⁰ 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.

²¹ TIGTA, Ref. No. 2012-30-06, *Despite Some Favorable Partnership Audit Trends, the Number of No-Change Audits Is a Concern* (June 2012).

- **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 Season to detect identity theft tax refund fraud before it occurred.²² These efforts included designing new identity theft screening filters that the IRS indicates will improve its ability to identify false tax returns before the tax return is processed and before a fraudulent tax refund is issued. As of April 19, 2012, the IRS reported that it stopped the issuance of \$1.3 billion in potentially fraudulent tax refunds as a result of these new filters.

- **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, and 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.²³ 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 system(s) 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 (U.S.) 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.²⁴ 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

²² TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

²³ TIGTA, Ref. No. 2010-40-127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (Sep. 2010).

²⁴ Loving v. IRS, 2013 U.S. Dist. LEXIS 7980 (D.D.C. Jan. 18, 2013).

Preparer Tax Identification Number (PTIN) program.²⁵ The IRS filed a notice of appeal to the District of Columbia Circuit Court on February 20, 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.²⁶

- **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 the CADE 2 daily processing allowed the IRS to process tax returns for individual taxpayers more quickly by replacing existing weekly processing.²⁷ 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. The IRS's modernization efforts also include the development of computer programs to conduct predictive analytics to reduce refund fraud. The successful implementation of the IRS's modernization program should significantly improve service to taxpayers and enhance Federal tax administration.

²⁵ Loving v. IRS, 2013 U.S. Dist. LEXIS 13878 (D.D.C. Feb. 1, 2013).

²⁶ TIGTA, Ref. No. 2012-30-045, *Improved Oversight Is Needed to Effectively Process Whistleblower Claims* (Apr. 2012).

²⁷ TIGTA, Ref. No. 2012-20-122, *Customer Account Data Engine 2 System Requirements and Testing Processes Need Improvements* (Sep. 2012).

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

TIGTA has also identified several concerns with both estimating the Tax Gap and efforts to reduce the Tax Gap. For example, the IRS has not developed an estimate for the international portion²⁸ of the Federal Tax Gap. Some estimates outside of the Federal Government place the estimate between \$40 billion and \$123 billion.²⁹ Another concern about the IRS's methods to estimate the size of the Tax Gap is that the sample sizes for the employment tax study may be insufficient to determine compliance levels.³⁰

TIGTA has identified other areas where the IRS could improve operations to help reduce the Tax Gap. For example, 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. This can be done by imposing an economic cost on taxpayers who choose not to voluntarily comply with our tax laws. 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.³¹ 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

²⁸ 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.

²⁹ 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).

³⁰ 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).

³¹ TIGTA, Ref. No. 2010-30-059, *Accuracy-Related Penalties Are Seldom Considered Properly During Correspondence Audits* (June 2010).

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.³² 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 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.³³ TIGTA reviewed 116 audits of sole proprietors 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.

AFFORDABLE CARE ACT

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. Revenue provisions contained in the

³² TIGTA, Ref. No. 2011-30-004, *Penalty Cases for Failure to Disclose Reportable Transactions Were Not Always Fully Developed* (Dec. 2010).

³³ 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).

legislation are designed to generate \$438 billion over 10 years³⁴ to help pay for the overall cost of health care reform. Additionally, new reporting requirements have been established.

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.³⁵ 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 data needs.

The health care reform becomes effective December 31, 2013. This provision is the requirement for individuals to maintain minimum essential health care coverage or face a continuous penalty. Starting in Calendar Year 2014, the IRS will be responsible for implementing the premium assistance credit³⁶ 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.³⁷ The ACA will further stretch these already limited resources.

The IRS projected its fiscal years 2012 and 2013 ACA staffing needs to be 1,278 FTEs and 859 FTEs, respectively. The IRS has not projected staffing needs beyond FY 2013.³⁸ Additionally, a lack of documentation to support the staffing requirements needed to implement the ACA precluded TIGTA from providing an opinion on the adequacy of staffing requests to support implementation.

³⁴ Joint Committee on Taxation, JCX-17-10, Estimated Revenue Effects of the Amendment in the Nature of a Substitute to H.R. 4872, the "Reconciliation Act of 2010," as Amended, in Combination With the Revenue Effects of H.R. 3590, the "Patient Protection and Affordable Care Act ('PPACA')," as Passed by the Senate and Scheduled for Consideration by the House Committee on Rules on March 20, 2010 (March 20, 2010).

³⁵ TIGTA, Ref. No. 2012-43-064, *Affordable Care Act: Planning Efforts for the Tax Provisions of the Patient Protection and Affordable Care Act Appear Adequate; However, the Resource Estimation Process Needs Improvement* (June 2012).

³⁶ A refundable credit which is payable in advance directly to the insurer, which will subsidize the purchase of certain health insurance plans through an exchange.

³⁷ 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).

³⁸ TIGTA, Ref. No. 2012-43-064, *Affordable Care Act: Planning Efforts for the Tax Provisions of the Patient Protection and Affordable Care Act Appear Adequate, However, the Resource Estimation Process Needs Improvement* (June 2012).

IDENTITY THEFT AND TAX REFUND FRAUD

Identity Theft

Despite the increased number of identity theft incidents the IRS has found, the IRS is still challenged in detecting and preventing them. 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, 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 issue approximately \$21 billion in fraudulent tax refunds resulting from identity theft over the next five years.

Incidents of identity theft affecting tax administration have continued to rise since Calendar Year 2011, when the IRS identified more than one million incidents of identity theft that impacted our Nation's tax system. During Calendar Year 2012, the IRS identified more than 1.7 million incidents, including more than 277,000 incidents in which taxpayers contacted the IRS alleging that they were victims of identity theft,⁴⁰ as well as more than 1.5 million incidents where the IRS detected the occurrence of potential identity theft.⁴¹

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.

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.

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

⁴⁰ Taxpayers can be affected by more than one incident of identity theft. These incidents affected 233,365 taxpayers.

⁴¹ These incidents affected 985,843 taxpayers.

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.⁴² 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.

The growth of identity theft presents considerable challenges to tax administration. In FY 2012, the IRS estimated that its inventory of more than 228,000 identity theft cases that had been carried over from FY 2010 to 2011 would require 287 staff years to resolve.⁴³ This inventory did not include 500,000 cases that were in the Duplicate Filing inventory,⁴⁴ many of which were identity theft cases.

In FY 2012, the IRS dedicated 400 additional employees to the Accounts Management function⁴⁵ to work identity theft cases. However, the inventory of identity theft cases grew 325 percent from FY 2011 to FY 2012—from approximately 88,000 in FY 2011 to more than 375,000 in FY 2012. Almost 200,000 identity theft cases were considered overage in FY 2012.

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 fraudulent 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 OI focuses its limited investigative resources on investigating identity theft that involves any type of IRS employee involvement, the misuse of client information by tax preparers, or the impersonation of the IRS through phishing schemes⁴⁶ and other means.

⁴² 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).

⁴³ One staff year is approximately 2,080 hours.

⁴⁴ A duplicate tax return condition occurs when a tax return posts to a taxpayer's account that already contains a tax return. The duplicate tax return becomes part of an inventory of duplicate tax return cases that require an IRS employee to work and resolve.

⁴⁵ The function that works the majority of identity theft cases involving individual duplicate tax returns.

⁴⁶ A fraudulent attempt, usually made through e-mail, to steal an individual's personal information.

For example, a former IRS employee was arrested⁴⁷ 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.⁴⁸ She subsequently pled guilty to those charges on August 14, 2012,⁴⁹ and is awaiting sentencing on March 28, 2013.

TIGTA OI 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 2008.⁵⁰ In 2010, he used the personal identifiers of other individuals to file false income tax returns and obtain refunds from the IRS.⁵¹ The preparer obtained most of the personal identifiers from his prior employment as a tax preparer and from other employment positions he held.⁵² He disclosed this information to co-conspirators so they could also file false income tax returns and obtain refunds from the IRS.⁵³ The subject and his co-conspirators ultimately defrauded or attempted to defraud the IRS out of at least \$560,000 in tax refunds.⁵⁴

As a third example, TIGTA OI investigated a phishing scheme where 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 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 restitution to his victims and a \$200 assessment.⁵⁵ According to the indictment, the subject and his co-conspirators operated a scheme to defraud numerous individuals through Internet solicitations, stealing more than \$1 million and the identities of those individuals.⁵⁶

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 OI has been successful in working

⁴⁷ E.D. Pa. Arrest Warrant executed July 5, 2012.

⁴⁸ E.D. Pa. Crim. Indict. filed June 26, 2012.

⁴⁹ E.D. Pa. Crim. Docket dated Jan. 22, 2013.

⁵⁰ S.D. Cal. Superseding Ind. filed June 19, 2012.

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ E.D.N.Y. Judgment filed Aug. 9, 2012.

⁵⁶ E.D.N.Y. Response to Defendant's Sentencing Letter filed Dec. 19, 2011.

with law enforcement personnel in foreign countries to identify the perpetrators and obtain prosecutions.

Finally, identity thieves may also impersonate IRS employees or misuse the IRS seal to induce unsuspecting taxpayers to disclose their personal identifiers and financial information for the purpose of committing identity theft. 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.⁵⁷ He then prepared and filed false Federal tax returns with the IRS in the names of various taxpayers without their knowledge or consent.⁵⁸ The tax returns contained W-2 information such as income and withholding that was falsely and fraudulently inflated.⁵⁹ The subject of the investigation used the refunds to purchase personal items.⁶⁰ 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.⁶¹

Refundable Credits

The IRS administers numerous refundable tax credits.⁶² The most significant refundable credit is the Earned Income Tax Credit (EITC). The American Recovery and Reinvestment Act of 2009 (Recovery Act)⁶³ also authorized several temporary refundable credits, one of which is the American Opportunity Tax Credit (AOTC). For several years, TIGTA has reported significant concerns with the growth in noncompliance and fraud in refundable tax credits.⁶⁴

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

⁵⁷ S.D.N.Y. Crim. Indict. filed Jan. 25, 2012.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ S.D.N.Y. Minute Entry filed July 11, 2012.

⁶² 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.

⁶³ Pub. L. No. 111-5, 123 Stat. 115. 2009.

⁶⁴ 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).

fraudulent tax refunds. The IRS estimates that it has paid between \$110 billion and \$133 billion in improper EITC payments from FYs 2003 through 2012.⁶⁵ It does not track estimates for the other refundable credits.⁶⁶

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 Calendar Year 2002. The risk continues to remain high that no significant improvement will be made in reducing EITC improper payments. The IRS estimates that EITC improper payments equated to \$12 to \$14 billion in FY 2012.

TIGTA further reported that although Executive Order 13520 requires the IRS to intensify its efforts to reduce EITC improper payments, reduction targets and strategies have not been established to reduce billions of dollars in improper payments made each year.⁶⁷ 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 (ACTC) 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).⁶⁸ 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.⁶⁹ The IRS could have saved more than \$108 million by reviewing claims made by taxpayers who were previously disallowed the credit.

In addition, TIGTA 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

⁶⁵ Department of the Treasury Performance and Accountability Reports for FYs 2003 through 2010 and the Agency Financial Report for FYs 2011 and 2012.

⁶⁶ TIGTA, Audit No. 201240045, *Compliance with the Improper Payments Elimination and Recovery Act of 2010*.

⁶⁷ 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).

⁶⁸ Pub. L. 111-204, 124 Stat. 2224. 2010.

⁶⁹ 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).

of the time, and the IRS will have to employ post-refund collection methods to recover the credits. 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 that appeared to be erroneous.⁷⁰ Another TIGTA audit found that individuals are claiming students for the AOTC, who, based on age, are unlikely to be pursuing an undergraduate degree or vocational certification.⁷¹ The Recovery Act provided funding to address college affordability and improve access to higher education. One tax provision amended the existing Hope Credit to allow a refundable tax credit, the AOTC, for higher education expenses up to \$4,000 for TY's 2009 and 2010. The maximum AOTC is \$2,500 per student and the first 40 percent of the credit (up to \$1,000) is fully refundable. Taxpayers can receive the credit only for students who attend at least half-time for at least one academic period and who are pursuing an undergraduate degree or vocational certification. The American Taxpayer Relief Act of 2012⁷² extended the AOTC for five years through Tax Year 2017.

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. We provided the information for the IRS's consideration to develop processes and procedures to identify similar claims to ensure that erroneous education credits were not paid. 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.

During the 2012 Filing Season, a filter was implemented to supplement the identity theft filters by detecting questionable AOTC claims by elderly taxpayers, because the combination of age and education credits are common indicators of potential identity theft. The IRS reported that as of June 22, 2012, it had frozen refunds

⁷⁰ TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sep. 2011).

⁷¹ 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).

⁷² Pub. L. No. 112-240, 126 Stat. 2313. 2013.

exceeding \$24 million on 2,517 accounts. It has corrected 2,672 accounts through correspondence or examination adjustments. Another 3,711 returns are in the examination process and 4,895 are being reviewed for potential identity theft, duplicate return conditions, or amended return consideration.

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 Service⁷³ for its toll-free telephone lines.⁷⁴ During the 2012 Filing Season, taxpayers made over 90 million attempts to call the various Customer Account Services function toll-free telephone assistance lines⁷⁵ seeking help in understanding the tax law and meeting their tax obligations.⁷⁶ 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.

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. The last year the IRS provided a Level of Service of more than 80 percent was FY 2007. This decrease 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.

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

⁷³ The primary measure of service to taxpayers. It is the relative success rate of taxpayers who call for live assistance on the IRS's toll-free telephone lines.

⁷⁴ 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).

⁷⁵ The IRS refers to the suite of 28 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

⁷⁶ Toll-free telephone assistance data presented in this report were taken from available IRS reports through the week ending April 21, 2012.

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

As a result, during the 2013 Filing Season, the IRS will again only provide tax returns 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.

HUMAN CAPITAL

The recruitment and retention of skilled employees is critical to the maintenance of a high-quality workforce capable of meeting the needs of the American public. The IRS has made progress in the management of its people (human capital); however, continued focus will be needed to provide reasonable assurance that the IRS has the right people in the right place at the right time to provide taxpayers with top-quality service and to enforce the law with integrity and fairness to all.

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 nonexecutive managers are currently eligible for retirement. Within five fiscal years, nearly 70 percent of all IRS executives and nearly one-half of the IRS's nonexecutive 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, in FY 2012, the IRS

eliminated funding for its Tuition Assistance Program due to budget constraints. The IRS had evaluated this program and determined that participants (compared to the general IRS population) showed lower attrition, more promotions, higher performance ratings, and higher employee engagement scores. In addition, the IRS is undergoing a change in top leadership. Commissioner 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 2013

As of March 5, 2013, the President had not submitted TIGTA's FY 2014 budget to Congress. In addition, TIGTA is operating under a Continuing Resolution with funding based on our FY 2012 enacted budget. For FY 2012, TIGTA's labor expenses were approximately 80 percent of our total budget.

TIGTA's FY 2013 budget request was \$153.8 million, which represents an overall increase of 1.41 percent above the FY 2012 enacted budget and includes \$324,000 needed to support the Council of the Inspectors General on Integrity and Efficiency. TIGTA's budget request reduces existing programs by over \$2.3 million below the FY 2012 enacted level. It also includes an additional \$4.5 million for 29 FTEs for oversight of the IRS's implementation of the numerous ACA tax provisions. Several key ACA provisions will become effective in FY 2013 and FY 2014, but FY 2014 will be 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 will require close coordination among the Audit, Investigations, and Inspections and Evaluations functions. Each program office brings unique skills and experience, but our 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 detect and 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.

TIGTA OI is also implementing two new enforcement initiatives to address critical tax administration issues.

Active Threat Response

In addition to protecting the integrity of Federal tax administration, TIGTA is responsible for protecting 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 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 investigated thousands of threats made against IRS employees. To address the potential danger that one of these tragic incidents would be focused on IRS employees, TIGTA special agents are being trained to respond to and neutralize an active threat which could endanger the lives of the approximately 92,500 IRS employees who are employed in over 670 facilities nationwide.

Bribery Awareness

A large portion of IRS employees are in direct contact with taxpayers and often encounter situations where a taxpayer may test 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 recently 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.

TIGTA EFFICIENCIES AND COST SAVINGS MEASURES

The following highlights TIGTA's efforts to achieve efficiencies and cost savings measures for both FY 2012 and FY 2013. These savings have resulted in funds put to better use by using our scarce budget resources more efficiently on higher priority programs, such as ensuring the safety and security of IRS employees and facilities and reviewing areas at high risk of fraud.

- During FY 2012, Phase One of TIGTA's revised Performance Management Program (PMP) was implemented, providing TIGTA managers and Audit, Inspections and Evaluations, and Counsel employees with training on how their

performance aligns with TIGTA's mission and organizational goals. PMP training was conducted in-house and enabled TIGTA to cancel an existing contract with a training vendor, achieving cost savings. Additionally, TIGTA achieved travel cost savings by delivering the training via videoconferencing. Phase II of the PMP will be implemented on October 1, 2013, and will include enhancements to the overall Program.

- TIGTA exceeded Treasury's FY 2012 Acquisition performance metrics and Small Business Acquisition Goals. Specifically, the total acquisition savings goal was exceeded by over \$670,000 or 454 percent, and the Change in Total High Risk Contracting goal was exceeded by 47 percent. The five Small Business Acquisition Goals were exceeded by 9 to 20 percent, despite multiple challenges and obstacles.
- TIGTA achieved acquisition cost savings in FY 2012 on our laptop refresh and other procurements. The laptop refresh savings will occur for four years.
- The Office of Information Technology reduced software costs in FY 2013 by eliminating redundancies in a software editing package and software security licenses.
- TIGTA has reduced its footprint of offices over the past few years to reduce rent costs. Specifically, in Calendar Year 2011, the Headquarters office space was significantly reduced by implementing hoteling, which has resulted in significant rent savings annually. The OA reduced its office footprint in Calendar Year 2010 and plans to close an additional office in FY 2013.
- The OA also achieved cost savings in FY 2012 by cancelling various classroom-based training and increasing the use of e-learning based training. In addition, the OA has steadily reduced its travel budget from FY 2010 to 2012 by 23 percent.
- The OI has implemented or will implement several cost-cutting measures in FY 2013. These initiatives include increased use of videoconferencing, reducing relocation costs, and delivering bribery-related training for IRS and TIGTA employees via webinars.

During 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 fraud, waste, and abuse. We will also identify

additional opportunities for cost savings, increased revenue, and revenue protection throughout 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 Crenshaw, Ranking Member Serrano, 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.