

WRITTEN STATEMENT OF

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HEARING ON

INTERNAL REVENUE SERVICE FY 2014 BUDGET REQUEST

BEFORE THE

SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT

COMMITTEE ON APPROPRIATIONS

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TABLE OF CONTENTS

I.	The IRS Budget Should Be Fenced Off from Across-the-Board Budget Cuts and Sequestration Because a Crippled IRS Means Inadequate Taxpayer Service, Less Revenue Collection, and Ultimately a Larger Budget Deficit.....	2
II.	If a “Program Integrity Cap Adjustment” Mechanism Is Used, It Should Encompass Taxpayer Service Activities as Well as Enforcement.	4
III.	A Reduction in the IRS Training Budget of More Than 80 Percent and Overly Rigid Training Approval Requirements Will Leave IRS Employees Ill-Equipped To Do Their Jobs and Meet Taxpayer Needs.	6
IV.	Conclusion.....	8

Chairman Lautenberg, Ranking Member Johanns, and distinguished Members of this Subcommittee:

Thank you for inviting me to submit this statement regarding the proposed budget of the Internal Revenue Service for FY 2014.¹

I have been privileged to serve as the National Taxpayer Advocate since 2001, and I have never been more concerned than I am today about the IRS's ability to fulfill its mission of helping taxpayers voluntarily comply with their tax obligations and collecting the revenue on which the rest of the government depends.²

Since FY 2010, the IRS's budget has been reduced by nearly \$1 billion, or about eight percent, due to across-the-board budget cuts and sequestration.³ Consequently, the IRS is unable to answer about one out of every three calls it receives from taxpayers seeking to speak with an employee.⁴ It is unable to process a high percentage of taxpayer letters responding to IRS compliance notices within established timeframes.⁵ It is unable to assist hundreds of thousands of identity theft victims in a timely manner, instead requiring them to wait six months or longer to receive their refunds.⁶ It continues to automate enforcement tasks, making it harder for taxpayers who need to

¹ The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

² In the National Taxpayer Advocate's 2011 and 2012 Annual Reports to Congress, I identified the significant and chronic underfunding of the IRS as one of the most serious problems facing taxpayers. See National Taxpayer Advocate 2012 Annual Report to Congress 34-41 (Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*); National Taxpayer Advocate 2011 Annual Report to Congress 3-27 (Most Serious Problem: *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*).

³ See Hearing Before Subcomm. on Financial Services and General Government of H. Comm. on Appropriations, 113th Cong. (2013) (statement of Steven T. Miller, Acting Commissioner of Internal Revenue), at <http://appropriations.house.gov/uploadedfiles/hhrg-113-ap23-wstate-millers-20130409.pdf>.

⁴ IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2012). The Accounts Management phone lines (previously known as the Customer Account Services phone lines) receive the significant majority of taxpayer calls. However, calls to compliance phone lines and certain other categories of calls are excluded from this total.

⁵ During the final week of FY 2012, the backlog of correspondence in the tax adjustments inventory stood at over one million letters, and the percentage classified as "overage" stood at 48 percent. IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 29, 2012).

⁶ See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*).

speak with an employee to do so.⁷ And by the end of FY 2013, it projects it will have cut its training budget by more than 80 percent, which in my view is leaving employees less able to assist taxpayers properly.⁸

On April 15, the statutory deadline for filing individual income tax returns, the IRS managed to answer only 57 percent of the calls it received.⁹ By any measure, 57 percent is an “F.” At the risk of understatement, the taxpaying public deserves better.

I. The IRS Budget Should Be Fenced Off from Across-the-Board Budget Cuts and Sequestration Because a Crippled IRS Means Inadequate Taxpayer Service, Less Revenue Collection, and Ultimately a Larger Budget Deficit.

The rationale for cutting federal spending generally is to help reduce the imbalance between spending and revenue. Yet the IRS is different from all other federal agencies: It is the revenue collector. Each dollar appropriated for the IRS generates substantially more than one dollar in federal revenue. In FY 2012, the IRS collected about \$2.52 trillion¹⁰ on a budget of about \$11.8 billion.¹¹ That translates to an average return-on-investment (ROI) of about 214:1. The marginal ROI of additional spending will not be nearly so large, but virtually everyone who has studied the IRS budget has concluded that the ROI of additional funding is positive. In 2011, former Commissioner Shulman estimated in a letter to Congress that proposed cuts to the IRS budget would result in reduced revenue collection of *seven times* as much as the cuts.¹²

⁷ See, e.g., National Taxpayer Advocate 2011 Annual Report to Congress 93-108 (Most Serious Problem: Automated “Enforcement Assessments” Gone Wild: IRS Efforts to Address the Non-Filer Population Have Produced Questionable Business Results for the IRS, While Creating Serious Burden for Many Taxpayers); see also National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2, at 63-90 (An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights), which notes that automation is leading to fewer personal contacts with taxpayers and lack of awareness among taxpayers that they are facing an enforcement action.

⁸ IRS Fact Sheet, FS-2013-05, *IRS Achieves \$1 Billion in Cost Savings and Efficiencies* (April 2013), at [http://www.irs.gov/uac/IRS-Achieves-\\$1-Billion-in-Cost-Savings-and-Efficiencies](http://www.irs.gov/uac/IRS-Achieves-$1-Billion-in-Cost-Savings-and-Efficiencies) (last visited May 1, 2013).

⁹ IRS, Joint Operations Center, *Accounts Management Rollup* (Apr. 15, 2013).

¹⁰ Government Accountability Office (GAO), GAO-13-120, *Financial Audit: IRS’s Fiscal Years 2012 and 2011 Financial Statements* 65 (Nov. 2012), at <http://www.gao.gov/assets/650/649881.pdf>.

¹¹ Department of the Treasury, *FY 2013 Budget in Brief*, at http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/11.%20IRS_508%20-%20passed.pdf.

¹² Letter from Douglas H. Shulman, Commissioner of Internal Revenue, to the chairmen and ranking members of the House Committee on Ways and Means (and its Subcommittee on Oversight) and the Senate Committee on Finance (Oct. 17, 2011), at http://democrats.waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/media/pdf/112/Rep_Lewis_IRS_Letter.pdf. In addition to generating direct revenue, IRS compliance actions produce indirect revenue gains. Studies show that taxpayers who might otherwise be tempted to bend the rules report their income more accurately as the likelihood of an audit increases.

If the Chief Executive Officer of a Fortune 500 company were told that each dollar allocated to his company's Accounts Receivable Department would generate seven dollars in return, it is difficult to see how the CEO would keep his job if he chose not to provide the department with the funding it needed. Yet that is exactly what has been happening with respect to IRS funding for years, and there has been little effort to fix this obvious problem.

This is not a new issue. It arises because the federal budgeting rules generally treat the IRS in the same manner as all other federal agencies, giving it no "credit" for the revenue it collects. Once this subcommittee receives its Section 302(b) allocation for the upcoming fiscal year, funding the programs under your jurisdiction is essentially a zero-sum game – each dollar allocated to one agency reduces the pool of funds available for others.¹³

In the National Taxpayer Advocate's 2006 Annual Report to Congress, I discussed the IRS funding challenge in detail and recommended, among other things, that Congress consider revising its budget rules in a manner that allows the relevant congressional committees to consider and decide: "What level of funding will maximize tax compliance, particularly voluntary compliance, with our nation's tax laws, with due regard for protecting taxpayer rights and minimizing taxpayer burden?" I recommended that Congress revise the budget rules so it could then set the IRS funding level accordingly, without regard to spending caps.¹⁴

In the course of developing and presenting that recommendation, my staff and I met with 14 separate congressional staffs – specifically, the House and Senate majority and minority staffs of the appropriations committees, budget committees, and tax-writing committees as well as tax counsel for the House and Senate majority leaders. In our discussions, there appeared to be no significant disagreement with the premise that the IRS generates a positive return on investment and is underfunded. However, we were repeatedly told that creating a new set of rules to establish IRS funding levels would be a "heavy lift" and would raise jurisdictional issues that have to be worked through. The

¹³ See Congressional Budget and Impoundment Control Act, Pub. L. No. 93-344, § 302(b)(1), 88 Stat. 297, 308 (1974) (providing that the Appropriations Committee of each House shall subdivide its allocation of funding under the annual budget resolution among its subcommittees). The "program integrity cap adjustment" mechanism, which I discuss in the text below, is a limited but flawed exception to this rule.

¹⁴ See National Taxpayer Advocate 2006 Annual Report to Congress 442-457 (Legislative Recommendation: *Revising Congressional Budget Procedures to Improve IRS Funding Decisions*), at http://www.irs.gov/pub/irs-utl/2006_arc_section2_v2.pdf.

last three IRS Commissioners have also raised these concerns.¹⁵ So have the former chairman and ranking member of the Senate Budget Committee.¹⁶

I believe the time to attempt the “heavy lift” is now. Not only are cuts to the IRS budget harmful from a taxpayer service perspective, but to the extent they are designed to reduce the budget deficit, they are self-defeating. For the reasons I have described, reductions in the IRS budget almost surely lead to a larger deficit. In fiscal terms, the IRS’s mission trumps those of all other agencies, because without an effective revenue collector, those agencies could not exist. If the IRS is not properly funded to collect the revenue, there will be fewer dollars available for the military, for social programs, for intelligence and embassy protection, for infrastructure maintenance, for medical research – or simply for deficit reduction.

Just as a Fortune 500 company would find a way to fund its accounts receivable department, I encourage the members of this subcommittee to work with their colleagues on the full Appropriations Committee, the Budget Committee, and the Finance Committee to exempt the IRS from across-the-board spending cuts and begin to recognize the IRS’s unique role as the agency that collects the revenue that makes all other government programs possible.

II. If a “Program Integrity Cap Adjustment” Mechanism Is Used, It Should Encompass Taxpayer Service Activities as Well as Enforcement.

In a partial attempt to address this problem, several Appropriations acts in recent years have given the IRS additional funding by using a mechanism known as a “program integrity cap adjustment.” Under this mechanism, new funding appropriated for IRS enforcement programs generally does not count against otherwise applicable spending ceilings provided:

1. The IRS’s existing enforcement base is fully funded; and
2. A determination is made that the proposed additional expenditures will generate an ROI of greater than 1:1 (*i.e.*, the additional expenditures will increase federal revenue on a net basis).

¹⁵ See, e.g., Charles O. Rossotti, *Many Unhappy Returns: One Man’s Quest to Turn Around the Most Unpopular Organization in America* 278 (2005) (“When I talked to business friends about my job at the IRS, they were always surprised when I said that the most intractable part of the job, by far, was dealing with the IRS budget. The reaction was usually ‘Why should that be a problem? If you need a little money to bring in a lot of money, why wouldn’t you be able to get it?’”).

¹⁶ In 2006, Senator Judd Gregg acknowledged that the existing budget procedures have the effect of shortchanging the IRS. He said: “We’ve got to talk to the [Congressional Budget Office] about scoring on [additional funding provided to IRS]. Clearly there’s a return on that money.” Dustin Stamper, *Everson Pledges to Narrow Growing Tax Gap*, 110 Tax Notes 807 (Feb. 20, 2006). Similarly, Senator Kent Conrad stated: “Rather than a tax increase, I think the first place we ought to look . . . is the tax gap. If we could collect this money, we’d virtually eliminate the deficit.” Emily Dagostino, *Senate Budget Resolution Would Increase IRS Enforcement Funding*, 110 Tax Notes 1129 (Mar. 13, 2006).

The Administration's budget proposal released last month recommends a change to the Balanced Budget and Emergency Deficit Control Act of 1985 to provide program integrity cap adjustments for the next ten years.¹⁷ While this cap adjustment mechanism may provide an easier path to providing the IRS with more resources than a fundamental change in IRS funding rules, I am concerned that taxpayer service activities have been excluded from this enhanced funding mechanism in the past and would continue to be excluded under the Administration's proposal. The rationale has been that the IRS is able to measure the direct ROI of its enforcement activities – *i.e.*, it can compute to the dollar the amounts collected by its Examination, Collection, and document-matching functions – but is unable to quantify the ROI of taxpayer services. Thus, it is not currently possible to document whether or to what extent its taxpayer services generate an ROI greater than 1:1.

Creating a mechanism that allows more funding for enforcement actions while excluding taxpayer service activities like outreach and education would be a mistake, for two reasons. First, common sense tells us that taxpayer services are a significant driver of tax compliance and generate a very high ROI. Publishing tax forms and instructions, conducting outreach and education, assisting taxpayers, tax preparers, and tax-software manufacturers, and otherwise administering the tax filing season are absolute prerequisites for tax compliance. In general, the ROI of these service activities is probably greater than the ROI of enforcement actions. As I discussed in detail in the National Taxpayer Advocate's 2012 Annual Report to Congress, the IRS could greatly improve its taxpayer services if it received additional funding for that purpose.

Second, an enforcement-only cap adjustment will inherently push the IRS to become more of a hard-core enforcement agency. It should be emphasized that in FY 2012, direct enforcement revenue amounted to only \$50.2 billion,¹⁸ or two percent of total IRS tax collection of \$2.52 trillion.¹⁹ The remaining 98 percent resulted from voluntary front-end tax compliance. If cap adjustments are applied solely to bolster enforcement funding, the relative allocation of the IRS budget between enforcement and taxpayer service will shift over time in a direction that causes taxpayers to fear the IRS more and voluntarily cooperate less. Primarily because of the proposed cap adjustments, the Administration's ten-year funding projections show that funding for the IRS Enforcement appropriation would increase by more than twice as much as funding for the IRS's Taxpayer Services appropriation.²⁰ In our effort to enforce the laws against

¹⁷ See Department of the Treasury, General Explanations of the Administration's Fiscal Year 2014 Revenue Proposals 187 (Apr. 2013).

¹⁸ IRS, Fiscal Year 2012 Enforcement and Service Results, at <http://www.irs.gov/pub/irs-news/FY%202012%20enforcement%20and%20service%20results-%20Media.pdf>.

¹⁹ GAO, GAO-13-120, *Financial Audit: IRS's Fiscal Years 2012 and 2011 Financial Statements* 65 (Nov. 2012), at <http://www.gao.gov/assets/650/649881.pdf>.

²⁰ Budget of the United States Government: Analytical Perspectives, Supplemental Materials Fiscal Year 2014: Table 32-1, Federal Programs by Agency and Account, at 304-305, at

noncompliant taxpayers, we must take care to avoid steps that may alienate compliant taxpayers and thereby jeopardize the existing tax base.

If program integrity cap adjustments are used, I recommend that compliance initiatives be defined more broadly, so they include both an enforcement component and a service component (e.g., better outreach, education, and assistance for small businesses). Because the projected ROI of many enforcement programs is high, a more broadly constructed initiative could still produce a demonstrable ROI of greater than 1:1, even if it contained service components with ROIs that are unquantifiable.²¹

III. A Reduction in the IRS Training Budget of More Than 80 Percent and Overly Rigid Training Approval Requirements Will Leave IRS Employees Ill-Equipped To Do Their Jobs and Meet Taxpayer Needs.

I am deeply concerned about the dramatic reduction in the training budget for IRS employees. Because of budget constraints, the IRS's full-time, permanent workforce was cut from about 86,000 to 79,000 employees from FY 2010 to FY 2012, a decrease of eight percent.²² This workforce reduction makes it imperative that the remaining IRS employees receive top-quality training so they can perform their jobs as effectively and efficiently as possible. Yet the IRS estimates that by the end of FY 2013, it will have cut its training budget by 83 percent as compared with FY 2010.²³

http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/32_1.pdf. Taxpayer service spending is shown on the top line, which is labeled "Taxpayer Services: Appropriations, discretionary . . . 803." Enforcement spending is the sum of the line labeled "Federal law enforcement activities: Appropriations, discretionary . . . 751" and the line labeled "Central fiscal operations: Appropriations, discretionary . . . 803." Over the FY 2014 through FY 2023 period, these projections show that Taxpayer Services spending would rise by 23 percent, while Enforcement spending would increase by 54 percent.

²¹ In our past annual reports, we have written about local compliance initiatives the IRS has undertaken that include integrated enforcement and outreach and education components. See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 176-192 (Most Serious Problem: *Local Compliance Initiatives Have Great Potential but Face Significant Challenges*). One example: In the early 1990s, the IRS launched an initiative designed to address noncompliance by fishermen in Alaska that resulted from confusion as well as community norms and attitudes. The IRS combined stepped-up enforcement activities with an extensive outreach and education campaign in remote fishing villages and on fishing vessels that included assisting with tax return preparation and training local volunteers to assist taxpayers. By the end of the initiative, the number of nonfilers among the target population declined by 30 percent. *Id.* at 177-178.

²² IRS Integrated Financial System, Commitments, Obligations, Expenditures & Disbursements report. These figures track employees in "pay status" and exclude employees who were on Leave Without Pay or related statuses.

²³ IRS Fact Sheet, FS-2013-05, *IRS Achieves \$1 Billion in Cost Savings and Efficiencies* (April 2013), at [http://www.irs.gov/uac/IRS-Achieves-\\$1-Billion-in-Cost-Savings-and-Efficiencies](http://www.irs.gov/uac/IRS-Achieves-$1-Billion-in-Cost-Savings-and-Efficiencies) (last visited April 12, 2013). From FY 2010 to FY 2012, the IRS already cut its training budget from about \$168 million to about \$63 million, a reduction of 62 percent. IRS Integrated Financial System, Commitments, Obligations, Expenditures & Disbursements report.

I view this as a very serious problem. In most years, workforce attrition exceeds five percent. When employees leave, the IRS must identify existing or new employees to pick up the slack – sometimes with internal promotions, sometimes with limited new hires. In addition, the IRS employs thousands of seasonal employees during the filing season and for other limited tasks throughout the year. And even employees who do not change jobs face constant changes in the nature of their workloads. For example, as the problem of tax-related identity theft has increased, the IRS has had to train and assign thousands of employees to work in that area.

The IRS has tried to train employees at lower cost by replacing in-person training with remote instruction. That is a constructive approach to a point. Some types of training can effectively be provided remotely. But other types, such as teaching taxpayer-facing employees how to interview taxpayers and working through case studies, do not lend themselves well to a virtual setting. In addition, employees of many IRS functions are spread around the country, and it is difficult for IRS managers to do their jobs properly if they cannot meet periodically – face to face – with the employees they supervise. In my view, it is impossible to cut the IRS's training budget by 83 percent without impairing the ability of IRS employees to perform their jobs effectively.

The IRS, pursuant to a Treasury Department directive, has implemented new rules that require executives who manage the major IRS functions, myself included, to obtain prior approval from the Deputy Commissioner for any training (or other event) that will cost \$3,000 or more.²⁴ As a practical matter, this low threshold has made most in-person meetings impossible. Considering the costs of airfare, local transportation, hotel accommodations, and per diem reimbursements, attendance by more than two persons in many cases will generate costs above \$3,000. By analogy, these rules are akin to requiring Senators and their staffs to obtain advance written permission from the Majority Leader before visiting the states they represent, including their state offices, or attending any conferences outside Washington, D.C. – on the theory that “virtual” town halls are just as effective as being there. The quality of the communication is simply not equivalent. My own organization, the Taxpayer Advocate Service, used to provide a rigorous one-week training session each year for all of our employees. It is not reasonable to expect employees to sit in front of a computer screen for a full week and absorb the same level of information they would receive from classroom presentations, interactive case studies, and discussions.

Nor has it become easier to provide remote instruction. One major alternative to in-person meetings is the use of the IRS's production studio at the New Carrollton Federal Building, where trainings can be taped and then made available to employees wherever they work. The Acting IRS Commissioner has stated: “Utilizing the production studio

²⁴ See Interim Guidance Memorandum, Control No. CFO-01-1212-01 (Dec. 27, 2012) (issued pursuant to Treasury Directive 12-70 (Nov. 28, 2012), at <http://www.treasury.gov/about/role-of-treasury/orders-directives/Pages/td12-70.aspx>). The Deputy Commissioner herself can only approve training and travel up to \$24,999. Any training or travel over that threshold must be sent to the Treasury Department for approval.

allows the IRS to provide education and training to large audiences, both within the IRS and to the public, often while reducing travel and other costs associated with such programs.”²⁵ I share his view that the production studio is an appropriate and low-cost alternative to in-person meetings for some types of training, yet the IRS has imposed stringent approval requirements on all virtual training sessions that utilize the production studio. Specifically, the IRS leadership has directed that “no videos should be produced until further notice unless the project has been reviewed by the Video Editorial Board and approved by the business unit head of office and the Deputy Commissioner for Operations Support.”²⁶

With the frequency of changes in the tax law, the concomitant need to reiterate taxpayer rights protections, the need to train new employees and those promoted to new positions, the use of thousands of seasonal employees, the dramatic expansion in tax-related identity theft, and the ongoing preparations to administer the tax provisions of the Patient Protection and Affordable Care Act, IRS employees desperately need top-notch training and updates to enable them to do their jobs. Rather than facilitating training, the IRS has imposed a series of roadblocks that, from a taxpayer perspective, mean that employees often will not have the information they need to make the right decisions, accurately answer taxpayer inquiries, or adequately protect taxpayer rights.

IV. Conclusion

For the reasons I have described, I believe it is time for this subcommittee and others to give serious thought to the way the IRS is funded and consider changing the budget rules to reflect the IRS’s unique role as the agency that collects federal revenue. For almost all other programs, a reduction in funding helps to reduce the federal budget deficit. For the IRS, a reduction in funding increases taxpayer noncompliance and ultimately increases the deficit. The budget rules today do not reflect that dichotomy, but they should. Therefore, I believe that as a first step the IRS budget should be fenced off from future across-the-board cuts and from the effects of the current sequester. Over the longer term, I encourage this subcommittee to find a way to set IRS funding levels in a manner that focuses on maximizing revenue collection, with due regard for protecting taxpayer rights and minimizing taxpayer burden, outside the zero-sum game limitations imposed by the Section 302(b) allocations.

When we require U.S. citizens and others to pay over a large percentage of their incomes to the government, we have an obligation to make the process as painless as

²⁵ Letter from Steven T. Miller, Acting Commissioner of Internal Revenue, to Hon. Charles Boustany Jr., M.D., Chairman, Subcommittee on Oversight, House Committee on Ways and Means (March 4, 2013).

²⁶ Memorandum from Beth Tucker, Deputy Commissioner, Operations Support, to Senior Executive Team, Additional Information on Video Production (March 7, 2013). The approval requirements are an understandable response to criticism the agency received for an over-the-top video that included a parody of *Star Trek*. When taken together with other training restrictions, however, the net effect is that employees will not have the knowledge to do their jobs properly.

possible. The IRS must be funded at a level that enables it to provide necessary taxpayer assistance and to enforce the laws, both to raise the revenue the government requires and to provide compliant taxpayers with assurance that others are paying their fair share. I am deeply concerned that recent cuts to the IRS budget are jeopardizing its ability to carry out this vital mission.