United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510–6200

September 7, 2004

The Honorable Mark W. Everson
Commissioner
Internal Revenue Service
1111 Constitution Avenue
Washington, DC 20224

Dear Commissioner Everson:

On July 15, 2004, the House Appropriations Subcommittee on Transportation, Treasury, and Independent Agencies reduced the Administration's budget request for the IRS by $382 million. We are writing to inquire how the proposed House cut of $382 million would affect IRS operations. Specifically, please respond to the following questions.

1. With a proposed cut of $382 million, what would be the impact on the IRS's fiscal year 2005 budget request? How would the cuts be allocated? How would these proposed cuts affect enforcement and service? How would the resulting cuts affect taxpayer compliance/noncompliance?

2. Would the IRS be able to complete its hiring plans? If not, how would personnel levels be affected? Would any areas experience staffing decreases? Please explain your answer.

3. What programs or initiatives would be reduced or eliminated? If so, describe the programs affected and the impact on tax administration. For example, what would the impact be on taxes assessed and collected? How would the cuts affect audit coverage? How many collection cases would be shelved as a result of the proposed cuts?

4. With IRS's enforcement initiatives, would IRS be able to make enough gains to stem the declines in enforcement? Please describe specific productivity gains the IRS expects to achieve.

Please submit your answers by September 15, 2004. If you have any questions, please do not hesitate to contact Anita Horn Rizek or Scott Landes at 224-4515. Thank you for your prompt attention to this request.

Sincerely yours,

Max Baucus

Max Baucus
Ranking Member

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

September 22, 2004

The Honorable Max Baucus
Ranking Member
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Senator Baucus:

Thank you for your letter dated September 7, 2004. You asked how the cuts the House has proposed to our FY 2005 budget request will affect our operations. I am pleased to provide the following information.

1. With a proposed cut of $382 million, what would be the impact on the IRS's fiscal year 2005 budget request? How would the cuts be allocated? How would these proposed cuts affect enforcement and service? How would the resulting cuts affect taxpayer compliance/noncompliance?

The IRS' FY 2005 budget request includes a substantial increase in funding for IRS enforcement activities, a cornerstone to stemming non-compliance among those taxpayers who choose not to fulfill their tax obligations. The $382 million reduction in funding proposed by the House committee would jeopardize the enforcement initiatives in the request and would substantially reduce our ability to hire an additional 4,100 enforcement personnel. Assuming the reduction in funding is limited to enforcement programs, the effect on service to taxpayers, however, would be less intrusive and the IRS likely would be able to maintain current service levels with base resources. Although the impact of the reduced funding on taxpayer compliance is difficult to quantify, we believe that, if enacted, the proposed cuts would reverse the progress we recently made in key enforcement areas.

2. Would the IRS be able to complete its hiring plans? If not, how would personnel levels be affected? Would any areas experience staffing decreases? Please explain your answer.

The House committee report does not provide the IRS the funding necessary to hire the additional 4,100 enforcement personnel needed to advance the IRS' key strategic objectives: discouraging and deterring individual non-compliance and corrosive activity among corporations, and identifying high income individual taxpayers engaged in abusive transactions and others who contribute to the tax gap. In addition, under the proposed reduction, the IRS would face a shortfall of over $80 million in funding needed to cover the salaries for the enforcement personnel we hired in FY 2004. Although the IRS will attempt to minimize the impact of this $80 million shortfall through further cost cutting, we likely would have to freeze hiring and not be able to cover employee losses in our service and enforcement areas, which would result in a net reduction in IRS staffing.

3. What programs or initiatives would be reduced or eliminated? If so, describe the programs affected and the impact on tax administration. For example, what would the impact be on taxes assessed and collected? How would the cuts affect audit coverage? How many collection cases would be shelved as a result of the proposed cuts?

The Administration's FY 2005 budget request seeks a substantial increase to IRS enforcement activities. We expect to achieve the following levels of performance with full funding of the requested FY 2005 initiatives:

- Examine an additional 30,000 investor returns in the Small Business and Self-Employed (SB/SE) business unit and increase coverage of high-income taxpayers, generating an additional $170 million in FY 2006. SB/SE also anticipates closing an additional 50,000 taxpayer delinquent accounts, resulting in an estimated $215 million in additional revenue.

- Hire and train over 2,000 new staff in the Examination, Collection and Document Matching programs. These increases will generate some $2.8 billion in direct enforcement revenue through FY 2007. Additional audits of investor returns and high-income taxpayers, together with 55,000 correspondence examinations, will yield more than $1.0 billion during that same period. Collection closures will increase by 240,000 and taxpayer contacts through the Automated Underreporter Program by some 300,000 through FY 2007 -- generating an additional $1.8 billion.

- Increase the overall audit coverage rate in the Large and Mid-Sized (LMSB) business unit from 5.1 percent in FY 2004 to 9.6 percent in FY 2007 and increase projected return closures by 63 percent from 16,067 returns in FY 2004 to 26,193 returns in FY 2007. Enforcement revenue recommended for the three years FY 2005 through FY 2007 should increase by over $3 billion.

- Complete 229 significant Corporate Fraud investigations through FY 2007. Tax-related completed investigations will increase by approximately 20 percent over the FY 2003 level by FY 2007.

- Hire 408 additional special agents and over 200 support personnel. In addition, Criminal Investigation is working to reduce elapsed time on completed investigations by 30 percent from FY 2002 levels.

If approved, the $382 million reduction proposed by the House committee would detrimentally affect each of these enforcement initiatives. Further, as noted in the response to the previous question, we would face a shortfall of over $80 million in funding needed to continue enforcement initiatives started in 2004. Consequently, the proposed reduction would affect initiatives of all four Operating Divisions and Criminal Investigation.

4. With IRS's enforcement initiatives, would IRS be able to make enough gains to stem the declines in enforcement. Please describe specific productivity gains the IRS expects to achieve.

As described in the answer to the previous question, we would make significant advances toward stemming the declines in enforcement. Our FY 2005 enforcement initiatives target the highest risk non-compliance activities, including detecting high-income individuals, corporations and tax exempt entities engaged in tax shelters and abusive tax avoidance transactions, preventing illegal diversion of charitable assets to terrorist causes, and uncovering corporate and other frauds. Our answer to the previous question describes the gains we expect to realize if the Congress fully funds our FY 2005 request.

If you have any questions or would like to discuss these issues further, please contact me or Floyd Williams, Director of the Office of Legislative Affairs, at (202) 622-4725 to schedule a meeting.

Sincerely,

Mark W. Everson