

**WRITTEN TESTIMONY OF
JOHN A. KOSKINEN
COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
SENATE FINANCE COMMITTEE
ON THE 2017 FILING SEASON AND IRS OPERATIONS
APRIL 6, 2017**

UPDATE ON THE 2017 FILING SEASON

Chairman Hatch, Ranking Member Wyden, and Members of the Committee, thank you for the opportunity to provide you with an update on the 2017 tax filing season and discuss IRS operations.

I am pleased to report that the 2017 filing season has gone well thus far in terms of tax return processing and the operation of our information technology (IT) systems. In fact, I believe this has been the smoothest filing season since I became Commissioner. As of March 31, the IRS received more than 93.6 million individual returns, on the way to a total of about 152 million. We have issued over 74.1 million refunds for more than \$213.5 billion, with the average refund totaling approximately \$2,900.

The smooth operation of the filing season is a testament to the hard work and dedication of the IRS workforce. It is important to note that administering the filing season does not happen automatically or by accident, but because thousands of IRS employees spend months planning in advance for the filing season and then administering it effectively.

The 2017 filing season is notable for certain Protecting Americans from Tax Hikes (PATH) Act changes that were enacted in 2015 and took effect this year. One of those provisions requires the IRS to delay the payment of tax refunds until February 15 each year to taxpayers who claim either the Earned Income Tax Credit (EITC) or the Additional Child Tax Credit (ACTC). Although this change slowed the overall pace of refunds at the beginning of the filing season, that pace accelerated once the IRS released approximately \$51 billion in EITC and ACTC refunds after February 15.

The new requirement to hold EITC and ACTC refunds, and another change enacted by Congress to accelerate the filing date of Form W-2s, have together helped the IRS improve its ability to spot incorrect or fraudulent returns. Receiving W-2s earlier has also assisted in the quicker release of refunds for those returns that appear suspicious but where we are able to verify the taxpayer's identity, which reduces unnecessary delays for compliant taxpayers.

Another PATH Act provision requires Individual Taxpayer Identification Numbers (ITINs) to expire if they were issued before 2013 or if they were not used on a federal tax return for three straight years. This change was also designed to increase the IRS's ability to detect and stop potential tax fraud.

I am pleased to say that the IRS has been able to implement these important revenue-protecting changes while delivering a successful filing season thus far. It is also important to note that Congress set the effective date for these changes about a year after enactment, which gave the IRS sufficient lead time to get our systems ready and also to prepare taxpayers and tax practitioners for the changes. We greatly appreciate this date, as adequate lead time is critical to maintaining the efficiency and seamlessness of our operations.

The lead time also allowed us to work extensively with many partner groups across the country and use various outreach and communications channels – including press releases, social media, speeches and the annual IRS Nationwide Tax Forums – to get the word out so people would understand what the changes would mean for them. This has greatly reduced the need for taxpayers to call or write us with questions.

TAXPAYER ASSISTANCE EFFORTS

Another critical component of the tax filing season involves the assistance the IRS provides to taxpayers through various channels, to help them fulfill their tax obligations as quickly and easily as possible.

One important area involves digital services. The IRS has been working to improve and expand our online offerings, in response to increasing taxpayer demand. We provide a wealth of tax information on IRS.gov, which was visited more than 500 million times during Fiscal Year (FY) 2016, and more than 320 million times so far in FY 2017. Taxpayers use IRS.gov to get forms and publications, find answers to their tax questions, and perform transactions such as paying their tax bill. The most heavily used part of our website is the “Where’s My Refund?” electronic tracking tool, which was used about 300 million times in FY 2016, and more than 228 million times already this filing season.

The IRS understands the need to continually improve the online content we provide to taxpayers. For that reason, over the last few years, we have updated many of the most-often used sections of IRS.gov through our Content Upgrade program. Over time, we have also launched a number of digital applications to further increase the security of taxpayers’ confidential tax information and improve taxpayers’ interactions with the IRS. These include:

- Get Transcript, which allows taxpayers to go online, verify their identity with strengthened security, and download a copy of their tax records from

prior years. Taxpayers have used this tool 7.4 million times so far in FY 2017;

- Online Payment Agreement, a secure, safe and easy process which taxpayers can use to set up a payment plan and pay their tax obligations over time. More than 247,000 online agreements have been set up so far in FY 2017; and
- Direct Pay, which provides taxpayers with a secure, free, quick and easy online option for making tax payments. This tool has been used more than 4.6 million times in FY 2017.

Our goal has been to find out how we can enhance and expand important services for all taxpayers, no matter what their circumstances.

In November 2016, we took the first step toward a fully functional IRS online account with the launch of an application on IRS.gov that provides information to taxpayers who have straightforward balance inquiries. This new feature allows taxpayers to view their IRS account balance, including the amount they owe for tax, penalties and interest, in a secure, easy and convenient way. Since its launch in December, this new tool has been used successfully about 547,000 times.

We recently added another feature that will let taxpayers see recent payments posted to their account. These balance-due and recent-payment features, when paired with existing online payment options, will increase the availability of self-service interactions with the IRS.

These are important steps, and over time, subject to the availability of resources, we will be adding other features to this platform as they are developed and tested with taxpayers and tax professionals. One such service improvement is Taxpayer Digital Communications. This feature, which is now in testing, provides a secure online messaging capability so that taxpayers, their authorized representatives and IRS employees can correspond electronically and resolve issues more quickly than through traditional mail while maintaining security.

As we improve the online experience, we understand the responsibility we have to serve the needs of all taxpayers, whatever their age, income or preferred method of communication. Although our research tells us that taxpayers increasingly prefer to interact with the IRS through digital channels, we recognize there will always be taxpayers who do not have access to the digital economy, or who simply prefer not to conduct their transactions with the IRS online.

Consequently, the IRS remains committed to providing the services these taxpayers need. In fact, we believe that providing more online services for those who want them will free up valuable resources to allow us to further improve service on our other channels – phone, in person, and correspondence, particularly for those taxpayers with more complex issues.

In regard to phone service, I'm pleased to report that during the 2017 filing season we are again seeing an improved level of service (LOS) on our toll-free lines, as we did in 2016. These improvements have been the direct result of the funding granted by Congress to improve service to taxpayers, as well as to strengthen cybersecurity and to expand our ability to address identity theft.

Our phone LOS currently is running above 76 percent, and we anticipate that the average for the 2017 filing season as a whole will be about 75 percent. We are still performing research to understand what other factors, aside from resources, may be contributing to this year's sustained high LOS. But we believe a major factor is a relative lack of major tax law changes enacted in 2016, which reduces the number of taxpayers calling with questions. Additionally, as noted above in regard to the PATH Act, the IRS had time to prepare taxpayers for those changes, which we believe also reduced the number of taxpayers needing to contact us this filing season.

Along with improvements in phone service, we have substantially reduced our correspondence inventory. In 2014 and 2015 this inventory grew significantly above normal levels, because our constrained funding forced us to shorten the period of employment for our seasonal employees who help answer taxpayer correspondence. To illustrate, inventory of pending correspondence stood at 900,000 at the end of FY 2014 and 859,000 at the end of FY 2015. By the end of FY 2016 that inventory had declined to 690,000, and now stands at about 660,000.

The IRS has also been successful in providing timely assistance this filing season to taxpayers who visit one of our Taxpayer Assistance Centers (TACs) located around the country. In recent years, TACs in many locations had experienced such heavy demand during the filing season that taxpayers were lining up for hours before the centers opened, just to ensure they would get in the door. To cut down on those long lines, the IRS in 2015 began testing a new way of doing business: letting people make appointments in advance, which is a process that had already been used successfully in other countries.

We found the pilot conducted in 2015 to be so successful that, with some adjustments, we moved to extend the appointment process to all TACs as of this year. I am pleased to report that the appointment process has dramatically cut wait times for taxpayers seeking assistance at TACs, and we have had no reports of long lines so far this filing season.

We have also found that this arrangement provides major advantages to the taxpayer. First, when a person calls for an appointment, we can tell them what documents they need to bring with them, reducing the number of return trips. Second, the IRS employee making the appointment can often help the taxpayer resolve their issue over the phone or refer them to the help they need, eliminating

altogether the need to visit a TAC. In fact, we have found that about 50 percent of the taxpayers who call for an appointment resolve their issues during that initial phone contact and do not need to make a personal visit to a TAC.

This fiscal year, through March 11, more than 1.3 million people have called for an appointment. Of that total, about 741,000 were able to resolve their issue over the phone, meaning there was no need for the time and expense of visiting a TAC. This is an important point, because TAC employees can now spend more time with those who do visit, as they tend to have more complex issues that cannot be resolved over the phone.

In implementing this new arrangement, we realized it would take time for people to adjust, so we have also served 685,000 people who walked in without an appointment so far this fiscal year, bringing the total number served so far in FY 2017 to approximately 2 million. The 685,000 number for walk-ins includes people who visit TACs to pick up a tax form or pay their tax bill. These are transactions for which no appointment is needed.

I would note that the operation of this filing season has been accomplished while using antiquated IT systems, as approximately 60 percent of the agency's hardware and 28 percent of its software are out of date and in need of an upgrade.

Congress enacted a number of provisions over the last several years that came with little or no funding for their implementation. This list includes: the Affordable Care Act (ACA); Foreign Account Tax Compliance Act (FATCA); a new certification program for professional employer organizations; reauthorization of the Health Coverage Tax Credit (HCTC); the registration requirement for newly created 501(c)(4) organizations; the seriously delinquent debt certification program; and the 2015 PATH Act changes noted above.

SAFEGUARDING IRS SYSTEMS AND TAXPAYER DATA

A critical component of tax administration, both during the filing season and throughout the year, involves safeguarding our systems and protecting taxpayer data, as well as working to thwart stolen identity refund fraud.

The IRS continues to work to protect our main computer systems from cyber incidents, intrusions and attacks, with our primary focus being on preventing criminals from accessing taxpayer information stored in our databases. These core tax processing systems remain secure, through a combination of cyber defenses, which currently withstand more than one million attempts to maliciously access our systems each day.

The IRS is also continuing its battle against stolen identity refund fraud. Over the last several years we have made steady progress, even within our reduced

resources, in protecting against fraudulent refund claims, criminally prosecuting those who engage in this crime, and helping minimize the adverse effect on victims.

That progress has accelerated since 2015, thanks to the collaborative efforts of the Security Summit Group. Over the past two years, this strong, unique partnership between the public and private sectors has allowed us to coordinate our efforts on many different levels. As a result, we put in place many new safeguards beginning in the 2016 filing season that produced real results. To illustrate, the number of people who reported to the IRS that they were victims of identity theft declined from 698,700 in Calendar Year (CY) 2015 to 376,500 in CY 2016 – a drop of 46 percent.

Even with this progress, the fraud filters in our processing systems are still catching a large number of false returns, which shows that identity theft continues to be a major threat to tax administration. During FY 2016, our systems stopped more than \$6.5 billion in fraudulent refunds on 969,000 tax returns confirmed to have been filed by identity thieves.

Along with the work being done by the Security Summit Group, another critical factor in our ability to improve efforts against stolen identity refund fraud has been the development and phase-in over the last several years of the Return Review Program (RRP). The RRP delivers an integrated and unified system that enhances IRS capabilities to detect, resolve, and prevent criminal and civil tax non-compliance.

This filing season, through the use of the RRP, we have become even more sophisticated than before in detecting anomalies in both paper and electronic tax returns. This has allowed us to continue strengthening our anti-fraud filters to block false returns before a refund can be issued. This year through March 22, the RRP has selected approximately 631,000 potentially fraudulent tax returns claiming approximately \$4.7 billion in refunds. We have developed RRP to identify all of our fraud cases that were previously identified by our legacy system, the Electronic Fraud Detection System (EFDS).

Despite all the progress we have made, we realize we cannot let up in the fight against identity theft. We are finding that, as the IRS improves monitoring capabilities and shuts off certain avenues of entry, identity thieves look for new ways of getting in. As the IRS enhances return processing filters and catches more fraudulent returns at the time of filing, criminals attempt to become more sophisticated at faking taxpayers' identities so they can evade those filters and successfully obtain fraudulent refunds.

Therefore, the IRS is working not just to react better and faster, but to anticipate the criminals' next moves and stay ahead of them. To fully protect taxpayers and the tax system, the IRS must not only keep pace with, but also get ahead of,

criminals and criminal organizations, as they improve their efforts to obtain personal taxpayer information.

In that regard, we continue to be concerned that identity thieves, in their never-ending hunt for taxpayer data, are targeting tax return preparers. For that reason, the Security Summit Group in 2016 began a stronger collaboration with the tax practitioner community. Working with our Summit partners, the IRS has alerted tax practitioners to various identity-theft schemes focused on preparers that have come to light over the past year.

Additionally, the IRS, in conjunction with the states and the tax community, has been conducting a public awareness campaign aimed at return preparers, called "Protect Your Clients, Protect Yourself." The goal of this campaign is to get the word out to preparers about steps they can take themselves to safeguard taxpayer data and avoid becoming victims of identity theft. We also continue to educate and share similar information with individual taxpayers through the "Taxes Security Together" campaign, which is now in its second year.

Along with these initiatives, which have been very helpful, we have also undertaken a broader effort to protect the security of data and strengthen authentication standards for programs where we share taxpayer information.

One example of this effort was our decision last year to eliminate the electronic filing Personal Identification Number (PIN) as an option for taxpayers to use to verify their identity when filing their tax return. An electronic tool on IRS.gov allowed taxpayers to enter identifying information to receive the e-file PIN. After discovering unauthorized attempts had been made to obtain PINs using data stolen from sources outside the IRS, we halted use of the PIN. Although our analysis of the situation found that no personal taxpayer data was compromised or disclosed by IRS systems, and no fraudulent refunds were issued, we believe it was necessary to discontinue the PIN to protect taxpayers and their data.

Our efforts to strengthen authentication standards also extend to programs where taxpayer data is routinely shared with organizations that use it to verify eligibility for customers who apply for loans. Since last summer, we have been working with banks, mortgage companies and others to ensure they were implementing strong "know your customer" requirements.

Along those lines, in June 2016 the IRS announced new, stronger requirements for participants using the Income Verification Express Service (IVES). The IVES service is used by pre-screened companies who, in turn, are hired by mortgage firms and loan companies that need to verify applicants' income. Going forward, the IRS will only accept requests for taxpayer data from IVES participants who certify that they are using the new requirements to verify their clients.

We took this step out of an abundance of caution to protect taxpayer information as well as safeguard the vital IVES program. IVES has been a successful program for the government and the private sector since 2006, and participants have a strong track record. While the IRS has concerns about limited areas in the program, these center on suspicious activity and customer validation issues. At issue is whether all IVES participants are always fully validating their clients, a situation we are currently investigating.

Student financial aid is another area where we have concerns about the potential for unauthorized attempts at obtaining taxpayer information. We have been working with the Department of Education to secure the online process through which student financial aid applicants obtain their family's financial information, which they need in order to complete the Free Application for Federal Student Aid (FAFSA) or apply for an income-driven repayment (IDR) plan for their student loans.

As part of this effort, in early March we disabled our IRS Data Retrieval Tool (DRT) found on the fafsa.gov website after we became concerned about the misuse of taxpayer data by criminals masquerading as students. Our IT, cybersecurity and privacy experts spent the next three weeks working with their counterparts in the office of Federal Student Aid (FSA) to find a way to secure the data provided to applicants for financial aid.

We recognize the burden on applicants if the convenience of the IRS data retrieval return is not available. However, in the process of considering potential, short-term technical solutions, we realized that none of them could clearly ensure the protection of student loan applicant financial information. Therefore, as we announced last week, we will not be able to activate the DRT until longer-term system upgrades are implemented.

Families can still complete applications for student financial aid by manually providing the requested financial information from copies of their tax returns. And, if necessary, they can obtain a copy of those returns either online through the Get Transcript application, by mail, or from their tax preparer. Although we realize this is less convenient than obtaining the information online, we have a responsibility to ensure all of our online tools, such as the DRT, are fully protected from identity thieves.

LOOKING AHEAD

We recognize that Congress is considering possible legislation on tax reform, as well as other tax legislation. As your Committee knows, the IRS has a great interest in working with you to make sure that whatever legislation is enacted can be administered as efficiently and effectively as possible for taxpayers and the tax system as a whole. To that end, early consideration of the impact of tax law

changes on tax administration plays an important role in assisting IRS in achieving this goal.

We also encourage Congress to carefully consider the impact of the timing of tax law changes. It is our experience that implementation is smoother and less costly from both the government's and taxpayers' perspectives if there is sufficient lead time to ensure that the IRS can prepare both taxpayers and our own systems for those changes, as was the case with the PATH Act changes I referenced earlier.

Chairman Hatch, Ranking Member Wyden and Members of the Committee, that concludes my statement. I would be happy to take your questions.