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BEFORE THE
SENATE FINANCE COMMITTEE
ON IRS BUDGET AND CURRENT OPERATIONS
FEBRUARY 3, 2015

Chairman Hatch, Ranking Member Wyden and Members of the Committee, thank you for the opportunity to appear before you today to discuss the IRS' budget and current operations.

After just over a year as IRS Commissioner, it remains an honor for me to lead this great institution. My respect for the agency's role and admiration for its workforce continue to grow. I'm pleased to report that the 2015 tax filing season opened on schedule on January 20, and is going well so far.

Opening the current filing season on schedule was a major accomplishment, given the challenges we faced. I attribute this achievement to the dedication, commitment and expertise of the IRS workforce. Along with normal filing season preparations, there was a significant amount of extra work to get ready for tax changes relating to the Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA). We also had to update our systems to reflect the passage of the tax extender legislation in December.

Even with the demonstrated capacity of our work force to successfully meet these challenges to open filing season on time, I remain deeply concerned that the significant reductions in the IRS budget will degrade the agency's ability to continue to deliver on its mission during filing season and beyond. In fact, one of my highest priorities since becoming Commissioner has been to advise Congress about the ramifications of continued substantial cuts to our funding, and that is what I will focus on in my testimony today.

IRS funding has been reduced $1.2 billion over the last five years, from $12.1 billion in Fiscal Year (FY) 2010 to $10.9 billion in FY 2015. Just over a month ago, the agency's FY 2015 budget was cut by $346 million from FY 2014, to $10.9 billion. But the total reduction from last year is actually closer to $600 million when the $250 million increase in mandated costs and inflation are counted.

The IRS is now at its lowest level of funding since FY 2008. When inflation is taken into account, the current funding level is comparable to that of 1998. Since then, however, the number of individual and business tax filers has increased by more than 30 million, or 23 percent, along with the number of legislative mandates that the IRS is required to implement.

It is important to point out that prior to this year the IRS was already reducing costs in order to absorb the reductions to our funding that began in FY 2011. This has not been easy because labor costs are by far the largest portion of the IRS budget. In fact, approximately 75 percent of our budget represents staffing, which is critical to providing adequate levels of taxpayer service and maintaining robust compliance programs. Moreover, it is not possible to shift enforcement personnel into service jobs, or vice versa, without providing them with substantial training, which of course is resource-intensive.

Nonetheless, the IRS has for several years been working hard to reduce costs and find efficiencies in our operations. The IRS has implemented significant reductions in its non-labor spending. In an effort to promote more efficient use of the Federal government's real estate assets and to generate savings, the agency in 2012 began a sweeping office space and rent reduction initiative. We estimate that these measures have reduced rent costs by more than $47 million each year and reduced total IRS office space by more than 1.8 million square feet.

During the last several years, the agency generated annual savings of $60 million in printing and postage savings by eliminating the printing and mailing of selected tax packages and publications, and by transitioning to paperless employee pay statements.

We will continue our efforts to find savings and efficiencies wherever we can. But as I said in my testimony to the Appropriations Committees almost one year ago, the cuts to the IRS are so significant that efficiencies alone cannot make up the difference. Now, we are at the point of having to make very critical performance tradeoffs. There is simply no way around the severity of these budget cuts without taking some difficult steps. We have been attempting to cope by protecting the core operations of the agency, in the belief that we must not hollow out the organization. We must identify the things that absolutely need to get done, and do them well.

Our determination to protect the core operations of the agency has led us to the decision that we need to continue to invest in our workforce. The ability of the IRS to fulfill its mission depends on the experience, skills and dedication of our employees. We need to do everything we can to ensure that every employee has the leadership, systems and training to help us retain good employees, to support them in their work and to allow them to perform at the highest levels, whether they are involved in customer service, compliance programs or information technology (IT) infrastructure and operational support.

As part of this investment in our workforce, the IRS will continue to recognize qualifying employees who do exceptional work. Performance awards are a necessary incentive to motivate the workforce and retain highly qualified employees, and in that regard, I firmly believe they provide the agency and taxpayers with a good return on the dollar. This investment will ensure that highly qualified employees have an incentive to stay with the agency and improve performance. As a result of negotiations with the National Treasury Employees Union (NTEU), the overall pool for awards was reduced to about 1 percent of the bargaining unit (BU) employee salary base, which is significantly less than the 1.75 percent provided to these employees in previous years.

I recently worked with IRS senior leadership to determine how to allocate our limited resources in FY 2015. We reviewed our operations to determine where we could make cuts that would have the smallest possible impact on taxpayers and tax administration. In making these decisions, we strove to maintain a balanced and fair approach, keeping in mind the needs of both service and enforcement, to avoid overly harming one part of our mission in the attempt to maintain another.

Let me now describe for this Committee the difficult decisions we made to absorb the latest round of budget cuts, and the impacts of those decisions. They include:

- ***Delays to critical IT investments of more than $200 million.*** We anticipate that these delays will reduce taxpayer service and cost-efficiency efforts as well as reduce outside contractor support for critical IT projects. For example, we will not be replacing aging IT systems, increasing the risk of downtime and negatively affecting taxpayer service. In addition, we will not be able to invest upfront money to gain future operational savings, such as moving to a shared cloud infrastructure and reducing data center space.

- ***Enforcement cuts of more than $160 million*****.** We estimate the agency will lose about 1,800 enforcement personnel through attrition during FY 2015 that we are not able to replace. We anticipate the result will be fewer audits and resources focused on collection. We estimate that as a result of these enforcement cuts the government will lose at least $2 billion. In addition to the revenue loss, the curtailment of enforcement programs is extremely troublesome because these programs help create a deterrent effect that is the key to preserving high levels of voluntary compliance.

- ***Reductions in staffing during filing season totaling more than $180 million.*** Normally, IRS uses employee overtime and temporary staff to provide the extra resources needed during the busy filing season. However, IRS will be reducing overtime and seasonal staff hours during FY 2015. We anticipate that these cuts will result in delays in refunds for some taxpayers. People who file paper tax returns could wait an extra week — or possibly longer — to see their refund. Taxpayers with errors or questions on their returns that require additional manual review will also face delays in getting their refunds. It is also expected that the taxpayers will have to wait longer to get an answer to their questions from the IRS. In addition to responses to written correspondence taking longer, taxpayers will have more difficulty getting through to the IRS on the phone and in person. We anticipate that about 50 percent of callers will be able to get through to an assistor and as we get further into the filing season, the telephone level of service will continue to deteriorate, dropping below 50 percent. This means that for every person who tries to reach IRS by phone, only half will end up getting through. That is significantly below the FY 2014 average of 64 percent, which was itself below desired levels. The 50 percent who reach the IRS will face extended wait times that are unacceptable to all of us.

- ***Continuing the agency hiring freeze*.** The IRS is extending the exception-only hiring freeze begun by the IRS in FY 2011 through FY 2015. As a result, and assuming normal attrition rates, the IRS expects to lose approximately 3,000 additional full-time employees in FY 2015. That would bring the total reduction in full-time staffing since FY 2010 to over 16,000. The resulting reduction in staffing will have negative impacts on taxpayer service and enforcement as noted above.

Even with all of these reductions, the IRS still faces a significant budget shortfall for FY 2015. So at this time, the agency is contingency planning for the possibility of a shutdown of IRS operations for two days later this fiscal year, which will involve furloughing employees on those days. If this does become necessary, our goal will be to minimize disruption to taxpayers, employees and our operations. We will continue to do the best we can to avoid taking this drastic action. In fact, these dates will be very late in the fiscal year to give the agency time to do everything possible to avoid a shutdown and, if one is necessary, to do it at a time that causes as little disruption as possible.

The concerns I have about the IRS' funding level relate not only to the negative impact these cuts have on the present operations of the agency, but also the impact on our ability to advance the agency into the future and provide a more up-to-date and efficient tax filing process for the taxpaying public.

To the extent possible within our budget constraints, the IRS has already made some significant improvements in its technology to better serve taxpayers. For example, one of the most popular features on IRS.gov is the *Where's My Refund?* electronic tracking tool, which reduces phone traffic IRS receives regarding questions about refunds. Another good example is IRS Direct Pay, which provides taxpayers with a secure, free, quick and easy online option for making tax payments, reducing the need for IRS to process payments by check. Still another example is Get Transcript, a secure online system that allows taxpayers to view and print a record of their IRS account in a matter of minutes, saving taxpayers time and reducing IRS resources needed to process paper requests for transcripts.

In looking to the future, we believe that it is not an option to stay at our current level of funding, given the extent to which both taxpayer service and enforcement will suffer as a result. It is very troubling to me that these cuts prevent us from fully improving and modernizing our IT infrastructure and operations support. This hurts taxpayers and the entire tax community.

Earlier in this testimony I described some examples of IT projects that must be deferred as a result of budget reductions in FY 2015. But the problem is much broader. We are operating with antiquated systems that are increasingly at risk, as we continue to fall behind in upgrading both hardware infrastructure and software. Despite more than a decade of upgrades to the agency's core business systems, we still have very old technology running alongside our more modern systems. This compromises the stability and reliability of our information systems, and leaves us open to more system failures and potential security breaches.

In regard to software, we still have applications that were running when John F. Kennedy was President. And we continue to use COBOL programming language. COBOL was considered outdated back when I served as chairman of the President's Council on Year 2000 Conversion and it is extremely difficult to find IT experts who are versed in this language. I give our IT employees a tremendous amount of credit as keeping things going in the face of these challenges is really a major accomplishment.

It is important to point out that the IRS is the world's largest financial accounting institution, and that is a tremendously risky operation to run with outdated equipment and applications. Our situation is analogous to driving a Model T automobile that has satellite radio and the latest GPS system. Even with all the bells and whistles, it is still a Model T. Our core IT systems are not sustainable without significant further investment over the next few years.

The President's 2016 Budget provides $12.3 billion in base discretionary resources, an increase of $1.3 billion from FY 2015 to make strategic investments in the IRS to continue modernizing our systems, improve service to taxpayers, and reduce the deficit through more effective enforcement and administration of tax laws. The Budget also proposes a $667 million cap adjustment to support program integrity efforts aimed at restoring enforcement of current tax laws to acceptable levels and to help reduce the tax gap. This multi-year effort is expected to generate $60 billion in additional revenue over the next ten years at a cost of $19 billion, thereby reducing the deficit by $41 billion. In addition, there are several important legislative proposals in the President's FY 2016 Budget related to tax administration. Specifically, let me highlight the following proposals:

- ***Acceleration of information return filing due dates.*** Under current law, most information returns, including Forms 1099 and 1098, must be filed with the IRS by February 28 of the year following the year for which the information is being reported, while Form W-2 must be filed with the Social Security Administration (SSA) by the last day of February. The due date for filing information returns with the IRS or SSA is generally extended until March 31 if the returns are filed electronically. The Budget proposal would require these information returns to be filed earlier, which would assist the IRS in identifying fraudulent returns and reduce refund fraud, including refund fraud related to identity theft.

- ***Provide correctible error authority**.* The IRS has authority in limited circumstances to identify certain computation or other irregularities on returns and automatically adjust the return for a taxpayer, colloquially known as “math error authority.” At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific, newly enacted tax code amendments. The IRS would be able to significantly improve tax administration – including reducing improper payments and cutting down on the need for costly audits – if Congress were to enact the Budget proposal to replace the existing specific grants of this authority with more general authority covering computation errors and incorrect use of IRS tables. Congress could also help in this regard by creating a new category of “correctible errors,” allowing the IRS to fix errors in several specific situations, such as when a taxpayer’s information does not match the data in certain government databases.

- ***Authority to regulate return preparers.*** In the wake of court decisions striking down the IRS’ authority to regulate unenrolled and unlicensed paid tax return preparers, Congress should enact the Budget proposal to provide the agency with explicit authority to regulate all paid preparers. The regulation of all paid preparers, in conjunction with diligent enforcement, would help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system.

- ***Streamlined critical pay**.* The IRS Restructuring and Reform Act of 1998 increased the IRS’ ability to recruit and retain a handful of key executive-level staff by providing the agency with streamlined critical pay authority. This allowed the IRS, with the approval of the Treasury Secretary, to hire well-qualified individuals to fill positions deemed critical to the agency’s success, and that required expertise of an extremely high level in an administrative, technical or professional field. This authority expired at the end of FY 2013. The President’s budget request proposes renewing this authority, which is essential to ensuring that the IRS has needed expertise in a number of important areas, including IT – in particular, cyber security – as well as international tax compliance and operational support.

- ***Simplify large partnership audits.*** Auditing of large partnerships has become a very challenging area for the IRS, in part because the number and complexity of partnerships has grown significantly over the last several years, and also because of inefficiencies in the partnership audit rules contained in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The procedures set up under TEFRA were designed to improve tax administration by making it possible for the IRS to conduct audits at the partnership level, instead of auditing each individual partner. But TEFRA was enacted when partnerships generally were smaller than they are today, and before they had complicated tiered structures. Therefore, having to follow the TEFRA procedures is now more of a burden for the agency than a help. Congress could ease this situation by enacting the Budget proposal to streamlined audit procedures for large partnerships.

Chairman Hatch, Ranking Member Wyden and Members of the Committee, thank you again for the opportunity to discuss the IRS budget and current operations. Given the impacts we are already seeing on our ability to deliver on our mission, I believe it is vital that we find a solution to our budget problem, so that the IRS can be put on a path to a more stable and predictable level of funding. I look forward to working with Congress to do just that. This concludes my statement, and I would be happy to take your questions.