

**WRITTEN TESTIMONY OF
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BEFORE THE
HOUSE OVERSIGHT AND GOVERNMENT REFORM COMMITTEE
ON IRS OPERATIONS
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I. INTRODUCTION

Chairman Issa, Ranking Member Cummings and Members of the Committee, thank you for the opportunity to appear before you today to give you an overview of IRS operations and also discuss current practices and procedures within the exempt organizations area.

I am honored to serve as IRS Commissioner and to have the opportunity to lead this agency and its dedicated employees, because I believe that the success of the IRS is vital for this country. The agency collects about \$2.9 trillion each year, which is more than 90 percent of the revenue collected by the federal government. The activities of the IRS touch virtually every American. This is a challenging time for the agency, as it must continue to fulfill its dual mission of tax compliance and taxpayer service while dealing with substantial budget reductions as well as the management problems that came to light last year.

I want to begin by outlining for you what I believe are the IRS' key challenges and what I will focus on going forward.

In discussing the state of the IRS, no challenge facing our agency is greater than the significant reduction in funding that has occurred over the last several years. I am deeply concerned about the ability of the IRS to continue to fulfill its mission if the agency lacks adequate funding. It is important to note that the IRS continues to operate at near post-sequestration levels, with FY 2014 funding less than one percentage point above FY 2013 levels. Our current level of funding is clearly less than what the agency needs, especially to provide the level of taxpayer services the public has a right to expect.

At the same time, we recognize that there has been a loss of confidence among taxpayers and particularly within Congress in regard to the way we manage operations. One of my responsibilities is to ensure that we are minimizing risks and quickly solving management and operational problems that may arise, so that Congress can be confident that, when we request additional funding, the money will be used wisely. Taxpayers provide the funds we receive and they deserve to be confident that we are careful stewards of those resources.

Despite the limits on our resources, I remain impressed with the professionalism and commitment of our workforce. Our employees have continued, throughout these challenging times, to perform critical work for the IRS and the nation – helping people understand and meet their tax responsibilities while ensuring enforcement of the tax laws.

II. OVERVIEW OF IRS OPERATIONS

The most important activity the IRS undertakes each year is delivering a smooth and successful filing season. The current filing season started strongly and continues to go well. Through March 14, 2014, the IRS has received more than 75.1 million individual income tax returns and issued more than 61.6 million refunds for approximately \$179.8 billion. The average dollar refund is about \$3,000, and the IRS has directly deposited more than 52.7 million refunds to taxpayers thus far, a 0.7 percent increase over the same period last year.

When all is said and done, we expect to receive a total of approximately 150 million individual income tax returns this filing season, which is a stunning number when you step back and think about it, especially given that processing such a high volume of returns is an annual occurrence for this agency. It is important to remember that this doesn't happen automatically or by accident, but occurs as a result of the efforts of our highly experienced and capable workforce.

This filing season, as we do every year, the IRS provides services to taxpayers to help them fulfill their tax obligations. Notably, we have been working to meet taxpayers' increasing demand for self-service and electronic service options. We continue to improve and expand the amount of tax information and web services available to taxpayers through our website, IRS.gov. In Fiscal Year (FY) 2013, taxpayers viewed IRS.gov web pages more than 450 million times. These taxpayers used IRS.gov to get forms and publications, find answers to their tax questions, and check the status of their refunds. Taxpayers used the "Where's My Refund?" electronic tracking tool 132 million times in FY 2012 and 200.5 million times in FY 2013. We expect to see continued strong usage of "Where's My Refund?" this filing season.

For the 2014 filing season we have several new digital applications that will further improve taxpayers' interaction with the IRS. One of these is IRS Direct Pay, which provides taxpayers with a secure, free, quick and easy online option for making tax payments. Another innovation, Get Transcript, is a secure online system that allows taxpayers to view and print a record of their IRS account, also known as a transcript, in a matter of minutes. We are also in the final stages of revamping the IRS Online Payment Agreement, which allows taxpayers to apply for an installment agreement online. We have streamlined the application

process to make it quicker and easier. We expect to launch this improved product later this spring.

As a result of these and other improvements to IRS.gov, and because there were no significant tax law changes enacted in 2013, the volume of phone calls to our toll-free lines is actually down somewhat this filing season. Data available through March 14 show we initially were able to maintain a level of phone service of between 73 and 74 percent, meaning that between 73 and 74 percent of taxpayers who called this filing season got through to the IRS. That is above the average level for last year's filing season of 68.8 percent. We will continue working to maintain as high a level of phone service as possible within our resource limitations, but we remain concerned that as we go through the year, the average level of phone service may drop below 70 percent.

Another area of concern is the amount of time people are having to wait to get in-person help at our Taxpayer Assistance Centers (TACs). We have had reports from field staff of taxpayers lining up outside TACs well before the centers open in the morning to make sure they receive service the same day. We also hear of people waiting 90 minutes or more to be helped once they have arrived inside the TAC and taken a number for service. Expanding our online offerings can only go so far to ameliorate these problems.

Along with taxpayer service, another high priority for the IRS is maintaining a robust tax compliance program and building on the work that has been done to improve compliance in a number of areas. One of the most critical is refund fraud caused by identity theft. The IRS is making substantial progress in combating identity theft through a comprehensive and aggressive strategy that focuses on preventing refund fraud, investigating these crimes and assisting taxpayers victimized by identity thieves. For FY 2013, we launched over 1,400 investigations of refund fraud related to identity theft and obtained over 1,000 indictments and over 400 convictions. Whereas we once took over 300 days to resolve a taxpayer's problem as the victim of identity theft, we now resolve new cases in 120-135 days and are working to improve that performance.

Within our compliance programs, another critical area of focus involves stopping erroneous claims for refundable tax credits, particularly the Earned Income Tax Credit. We have initiated a major review of our activities in this area, including exploring potential partners and other data sources that will help us increase our ability to deter erroneous refund claims. because [insert explanation]. In addition, if Congress enacts the proposal in the Administration's FY 2015 Budget to provide the IRS with greater flexibility to address "correctable errors," we will have additional tools to stop erroneous claims.

Our priorities also include fulfilling our responsibilities to implement tax-related provisions of enacted legislation, including the Foreign Account Tax Compliance Act and the Affordable Care Act (ACA).

On the management side, we are continuing our efforts to address the issues and concerns that arose last year that related to the processing of applications for tax-exempt status. I will discuss these activities in greater detail later in the testimony.

In regard to our workforce, I strongly believe that the success of the IRS depends on the experience, skills and enthusiasm of our employees, and it is important for us to make the most of this very valuable resource. The recent visits I have made to various IRS offices and the meetings I have had with employees reinforce my long-held belief that the people in an organization who know the most about what is going on are the frontline employees. I intend to listen to our employees and make sure they understand that we appreciate their dedication and look forward to benefitting from their insights and suggestions. I have told our employees that I will do everything possible to ensure that they have the leadership, systems and training to support them in their work and allow them to reach their full potential to best serve taxpayers.).

In that regard, I was pleased that we were able to reach an agreement recently with the National Treasury Employees Union involving FY 2013 performance awards for Bargaining Unit (BU) employees. As a result of sequester, the IRS initially had made the tough decision to eliminate performance awards for FY 2013. However, because of negotiations with the NTEU that were already underway when I came on board in December, the IRS eventually agreed to make performance award payouts for FY 2013 of about 1 percent of the BU employee salary base, which is less than the 1.75 percent provided to these employees in previous years. This agreement with NTEU settles a national grievance and unfair labor practice.

Based on historic experience, we expect that about two-thirds of our employees will receive an award for FY 2013, and that the average amount paid to each employee will be approximately \$1,200. As a result of this agreement, BU employees will for the first time be on the same schedule as everyone else at the IRS, so that payouts will be made early in the fiscal year for work performed the previous year.

After spending time with many employees in various IRS offices over the last several weeks, I am convinced that this money is best spent on our employees. I firmly believe that this investment in our employees will directly benefit taxpayers and the tax system.

For the IRS to keep making progress in all the areas I have just mentioned, it is critical for us to receive adequate resources. As noted above, the agency continues to be in a very difficult budget environment, with our funding for FY 2014 now set at \$11.29 billion. Since FY 2010, IRS appropriations have been cut by more than \$850 million. This represents a 7 percent cut in our annual budget

since 2010 while the total population of individual and business filers grew by more than 4 percent over the same time period.

We recognize the need to become more efficient no matter what happens to our funding level. Labor is our largest operating expense and we have been very focused on managing personnel costs. By closely managing hiring and limiting replacement behind attrition, the IRS has reduced the total number of full-time, permanent employees by about 10,000, or more than 11 percent, since 2010.

The IRS has also implemented significant reductions in its non-labor spending. Since 2010, the IRS has reduced annual spending on professional and technical service contracts by \$200 million. Additionally, the IRS generated \$60 million in annual printing and postage savings by eliminating the printing and mailing of selected tax packages and publications, and by transitioning to paperless employee pay statements.

Finally, in an effort to promote more efficient use of the Federal government's real estate assets and generate savings, in 2012, the IRS announced a sweeping office space and rent reduction initiative that over two years is projected to close 43 smaller IRS offices and consolidate space in many larger facilities. These measures will reduce annual rent costs by more than \$40 million and reduce total IRS office space by more than 1.3 million square feet by the end of FY 2014. Thus, overall, we are spending \$300 million a year less in these areas.

We will continue our efforts to find savings and efficiencies wherever we can. The IRS will continue to carry out its core responsibilities and work toward preserving the public's faith in the essential fairness and integrity of our tax system. But these budgetary constraints continue to pose very serious challenges to our efforts to enforce the tax laws and provide excellent customer service. Essentially, the federal government is losing billions in revenue collection to achieve budget savings of a few hundred million dollars, since the IRS estimates that, for every \$1 invested in the IRS budget, it produces \$4 in revenue.

It is vital that we find a solution to our budget problem, and I look forward to working with Congress to do just that. I hope that one of the legacies of my four years as IRS Commissioner will be that we put the agency's funding on a more solid and sustainable footing.

III. EXEMPT ORGANIZATIONS

As noted above, one of my primary goals and responsibilities as IRS Commissioner is to restore whatever public trust has been lost over the course of the last several months as a result of the management problems that came to light last year in regard to the 501(c)(4) application process. Taxpayers need to

be confident that the IRS will treat them fairly, no matter what their background or their affiliations. Public trust is the IRS' most important and valuable asset.

While this remains a major area of focus for the IRS, it is important to keep this issue in perspective in relation to all the other critical work being done by the agency for the nation's taxpayers. The IRS has approximately 800 employees in our Exempt Organizations (EO) division, and only a small subset of that group works on processing applications for tax-exempt status. Meanwhile, there are more than 89,000 IRS employees in offices all across the country performing other essential duties – assisting taxpayers, carrying out compliance activities, and providing support to the organization – all in an effort to ensure that our tax system runs smoothly.

In regard to the determinations process for 501(c)(4) organizations, let me outline for you the improvements we have made, and continue to make, in this area.

First, the IRS as of January 2014 completed action on all nine recommendations contained in the May 2013 report by the Treasury Inspector General for Tax Administration (TIGTA).

The changes we have made in response to the TIGTA recommendations include:

- Establishing a new process for documenting the reasons why applications are chosen for further review;
- Developing new training and workshops on a number of critical issues, including the difference between issue advocacy and political campaign intervention, and the proper way to identify applications that require review of political campaign intervention activities;
- Establishing guidelines for IRS EO specialists on how to process requests for tax-exempt status involving potentially significant political campaign intervention; and
- Creating a formal, documented process for EO determinations personnel to request assistance from technical experts.

We have reduced the inventory of section 501(c)(4) applications, including the group of 145 cases in the “priority backlog” – those that were pending for 120 days or more as of May 2013. As of March 13, 2014, 126 of those cases, or 87 percent, have been closed. Of the closed cases, 98 of them were approved, including 43 organizations that took advantage of a temporary self-certification procedure we offered in summer 2013. Of the remaining 28 closed cases, most were closed either because the organization withdrew the application or it failed to respond to our questions. To date, three applications have been formally denied. The 19 cases still open generally fall into one of two categories: either the taxpayer has asked for and received additional time to respond to our questions, or the case is being litigated. None of these 19 organizations opted to accept the self-certification procedure used by 43 organizations to obtain prompt approval of their applications.

In addition, proposed regulations were released in November that are intended to provide clarity in determining the extent to which section 501(c)(4) organizations may engage in political activity without endangering their tax-exempt status. This initial guidance also seeks comments on other aspects of the section 501(c)(4) qualification requirements. These aspects include what proportion of an organization's activities must promote social welfare and how it should be measured. The proposed guidance also seeks comments regarding whether standards similar to those that have been proposed should be adopted to define the political activities that do not further the tax-exempt purposes of other tax-exempt organizations, which would promote consistent definitions across the tax-exempt sector.

It is important to note that TIGTA, the National Taxpayer Advocate and members of Congress all recommended that Treasury and the IRS consider issuing new guidance in this area. Our Notice of Proposed Rulemaking is consistent with those recommendations. I believe it is extremely important to make this area of regulation as clear as possible, not only because it will help guide the IRS in proper enforcement, but because it will also give a better roadmap to applicants and help those that already have section 501(c)(4) status understand the applicable standards and properly administer their organizations.

I note that there have been numerous misleading reports and public statements regarding the proposed regulations, and I believe it is important to clarify what the draft regulation does *not* do:

- First, the draft regulation does not restrict any form of political speech. It relates only to the qualification requirements for a particular type of tax-exempt status.
- Second, the draft regulation does not favor any individual political party or group. It applies to all organizations, regardless of political affiliation.
- Third, the draft regulation does not prevent politically active organizations from qualifying for tax-exempt status. Congress provided a clear mechanism for political groups to organize as tax-exempt organizations – that is, under Internal Revenue Code Section 527. The major difference is that Congress requires section 527 groups to be transparent and to disclose their financial donors. In requiring disclosure, Congress presumably made the judgment that political organizations should be open and transparent in their fundraising.
- Fourth, the draft regulation does not seek to impose greater restrictions on section 501(c)(4) organizations than on other tax-exempt organizations. It expressly seeks comments on whether the proposed rule should apply to other types of tax-exempt organizations.

As to the timeframe for this rulemaking, several more steps must be taken in the formal, legally prescribed process before the regulations can be finalized. Now that the public comment period has ended, Treasury and the IRS can begin to review and consider the comments submitted. This will take some time, given the

extraordinary number of comments, which total more than 150,000 – a new record for an IRS proposed regulation. Given the widespread interest in this rulemaking, we will likely hold a public hearing and, in all likelihood, revise the proposed regulations based on the comments and on the testimony provided at the hearing. If enough significant changes are made to the proposed regulations, it is possible they could be re-proposed, which would further lengthen the rulemaking process.

My hope is that Treasury and the IRS can fashion final regulations that will allow for easier and more predictable tax administration in this area. If we can achieve that goal, I am confident that this will help restore the public trust in the IRS. Although I do not control the policy decisions made in regard to rulemaking, the Treasury and the IRS have a longstanding history of working cooperatively in developing regulations, and I will do my best to ensure that any final regulation is fair, clear and easy to administer.

I believe it is vital that every taxpayer feel confident they will be treated fairly when they interact with the IRS, no matter what organization they belong to, what beliefs they hold, or whom they voted for in the last election. During my term as IRS Commissioner, no responsibility that I have is more important than ensuring we treat all taxpayers fairly and impartially whenever we interact with them.

In describing our activities in regard to the determinations process for tax-exempt status, which was the focus of the Inspector General's report last year, I think it is also important to point out that the IRS has been making and continues to make every effort to be as transparent as possible and cooperate with the six ongoing investigations into the 501(c)(4) application process – four investigations being conducted by Congress, one by the Justice Department and one by the Inspector General.

Over the last eight months the IRS has devoted significant resources to this Committee's investigation and requests for information, as well as those of other Congressional committees – transmitting documents and facilitating interviews in an effort to provide complete facts about the determinations process. More than 250 IRS employees have spent nearly 100,000 hours working directly on complying with the investigations, at a cost of nearly \$8 million. In order to properly protect taxpayer information while efficiently processing voluminous materials for production, we had to add capacity to our information technology systems and, therefore, spent an additional \$6 million to \$8 million to optimize existing systems and ensure a stable infrastructure.

To date we have produced more than 690,000 pages of unredacted documents to the tax-writing committees (which have section 6103 authority) and over 420,000 pages of redacted documents to this Committee and the Senate Permanent Subcommittee on Investigations. I understand that this Committee's staff has interviewed more than 30 current and former IRS employees, who have given more than 60 interviews to congressional staff.

In addition, we have responded to more than 50 different letters from Members of Congress about these issues, answered questions related to the subjects of these investigations at 15 hearings and engaged in hundreds of phone calls and meetings with Congressional staff regarding the production of documents and witnesses.

Last week, we informed this Committee and others that we believe we have completed our production to the Ways and Means and Finance Committees of all documents that we have identified as relating to the processing and review of applications for tax-exempt status as described in the May 2013 TIGTA report. We are continuing to cooperate with this Committee and other committees receiving redacted documents, and we will continue redacting and providing documents until that process is completed.

In light of these document productions, I hope that the investigations can now be concluded in the very near future. Once we have the resulting reports from these investigations, we can then take further corrective action where necessary. The conclusions and recommendations in these reports will be a critically important step in the process of learning from, addressing and moving beyond any problems or concerns that may be identified in the reports.

In the event that this Committee would, at some point in the future, decide to undertake investigations into other matters pertaining to the 501(c)(4) area, such as the rulemaking process or the examinations process, the IRS stands ready to cooperate with you.

IV. CONCLUSION

Chairman Issa, Ranking Member Cummings and members of the Committee, thank you again for the opportunity to provide you with an overview of IRS operations. Our work in all of the areas I have discussed is critical, and we will continue building on the progress already made. Going forward, our biggest obstacle to further progress in all areas, including taxpayer service, will be our significantly reduced level of funding. As I recently told our employees, it is important for us to remember that the challenges and problems we face won't be solved overnight. But I am confident that, working together, and with the help of Congress, we can meet those challenges and ensure that our agency can continue to deliver for the American taxpayer in the years to come. This concludes my statement, and I would be happy to take your questions.