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ON IRS ACTIONS TO REDUCE IMPROPER PAYMENTS
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I. INTRODUCTION

Chairman Mica, Ranking Member Connolly and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the IRS' efforts to stop improper payments in a number of high-priority areas: refund fraud caused by identity theft; the misuse of Individual Taxpayer Identification Numbers (ITINs); and erroneous claims for refundable tax credits, particularly the Earned Income Tax Credit (EITC).

Enforcement of the tax laws is a critical component of the U.S. tax system, as it enhances voluntary compliance with these laws. The IRS carries out a robust enforcement program that includes: a balanced examination program to help ensure that taxpayers accurately report their income, deductions and credits; a collection program, which seeks to collect assessed tax liabilities; and efforts to reduce tax fraud, which involve detecting and stopping fraudulent schemes and investigating these crimes. Taken together, the IRS' enforcement activities collected approximately $53.3 billion in taxes and penalties in Fiscal Year (FY) 2013. It is important to point out that for every dollar the IRS spends enterprise-wide, the return on investment (ROI) is more than $4.

The IRS continuously seeks to enhance and improve its enforcement efforts, particularly as they relate to improper payments. The IRS has made significant progress in several key enforcement programs, as I will explain in greater detail below. But in attempting to make further progress, we face several challenges.

One challenge is the sheer volume and complexity of tax fraud schemes. The tactics employed by unscrupulous individuals who commit these crimes are constantly evolving. This is particularly true in the case of refund fraud involving identity theft. In this area, we are having success in stopping small-scale fraud, but that means that we increasingly face sophisticated large-scale schemes perpetrated by organized criminals. Another related challenge is the need to further upgrade our technology. Criminals are hard at work reverse engineering our fraud filters, and we need new tools and technology in order to develop more sophisticated refund fraud filters and better taxpayer authentication procedures.

Our most serious challenge is the difficult budget environment we find ourselves in. The work we are already doing on reducing improper payments involves a difficult balance of resources and staffing at a time when our budget has been reduced significantly. Our funding for FY 2014 was set at $11.29 billion, which is more than $850 million below our level in FY 2010. Over the same time period, we lost almost 10,000 full-time permanent employees. It is important to note that the IRS continues to operate at near sequestration levels.

The solution to the funding problem we face begins with the Administration's FY 2015 budget request, which, with the inclusion of the program integrity cap adjustment and the Opportunity, Growth and Security Initiative, totals $12.64 billion. This is approximately $1.35 billion above the FY 2014 enacted level. This amount includes a $480 million program integrity cap adjustment to vitalize tax compliance and a $165 million additional investment through the Opportunity, Growth and Security Initiative to deliver performance enhancements that taxpayers deserve.

In the absence of these additional resources, our ongoing funding shortfall has major negative implications for taxpayers and the tax system in general and our efforts to reduce improper payments in particular.

II. IRS EFFORTS TO REDUCE IMPROPER PAYMENTS

Making Progress on Identity Theft

The IRS has a comprehensive and aggressive identity theft strategy that focuses on preventing refund fraud, investigating these crimes, and assisting taxpayers victimized by identity thieves. Fighting refund fraud caused by identity theft is an ongoing battle for the IRS, one where we have made significant progress in the last couple of years. But we realize that more needs to be done, and we are continuing to improve our processes to the extent that our funding situation will allow.

It is important to point out that preventing refund fraud involves a delicate balance because the IRS has a dual mission when it comes to issuing refunds. We must balance the need to issue refunds in a timely manner with the need to ensure that claims are proper and taxpayer rights are protected. Years ago, taxpayers could expect to wait several weeks for a refund. Now, however, with well over 80 percent of individuals filing their returns electronically and a large portion of them requesting direct deposit of their refund, the vast majority of taxpayers now receive their refund in 21 days or less from the time of filing. The speed in refund issuance presents an enforcement challenge since we typically receive the third-party information reporting needed to verify information reported on returns long after the refund is issued. Our ability to identify mismatches earlier in the process, and thus do a better job of stopping improper payments, would be greatly helped by the enactment of a legislative proposal in the

Administration's FY 2015 budget that would accelerate the filing due date for certain information returns. That proposal is discussed in greater detail later in this testimony.

Refund fraud detection

The IRS stopped 5 million suspicious returns in Calendar Year (CY) 2012 – up from 3 million suspicious returns stopped in CY 2011. This upward trend has continued and in CY 2013 we stopped 5.7 million suspicious returns, worth more than $17.8 billion. This year, through the end of May, about 3.7 million suspicious returns have been stopped, and we expect the number for the full year to be close to the total number stopped in CY 2013.

In 2008, we began placing an indicator on the accounts of taxpayers who had experienced identity theft. These indicators initially served two primary purposes: to speed up account reconciliation for the legitimate taxpayer and to reduce the likelihood that a taxpayer's information could be used for a fraudulent refund claim in subsequent years.

In 2011, we launched a pilot program to test the Identity Protection Personal Identification Number (IP PIN). The IP PIN is a unique identifier that authenticates a return filer as the legitimate taxpayer at the time the return is filed. The IP PIN is sent to the taxpayer immediately before the filing season for use on the return that will be filed during that filing season and is valid for only one filing season. The growth in the use of the IP PIN has been significant, from 250,000 IP PINs issued in filing season 2012 to more than 1.2 million IP PINs issued to victims of identity theft in the filing season just completed.

We also offered a limited pilot program for the 2014 filing season to test the idea of issuing IP PINs to individuals who have not previously been identity theft victims. Under the pilot, we offered certain taxpayers who filed a tax return last year from Florida, Georgia, or the District of Columbia an opportunity to apply for an IP PIN. We selected Florida, Georgia, and the District of Columbia for the pilot because they have the highest per-capita percentage of tax-related identity theft. Based on the results of this pilot, we will consider whether to expand issuing IP PINs to taxpayers in other locations.

Over the last two fiscal years the IRS has made numerous improvements in our efforts to protect identifying information, as well as catch fraud before refunds are issued:

- We have implemented new identity theft screening filters to improve our ability to spot false returns before we process them and issue refunds. We have also accelerated, to the extent we can under present law, the use of information returns in order to identify mismatches earlier.

- In cases where dozens or even hundreds of refunds go to a single bank account or single address, we added identity theft filters that flag these multiple refund situations for further review. We are also limiting the number of refunds that can be electronically deposited into a single financial account. Starting in January, direct deposit will be limited to three refunds into one account. Any subsequent refund will automatically be converted to a paper check and mailed to the address on the tax return. We will send out notices to those taxpayers informing them that their refunds are being mailed and they should expect to receive them in about four weeks from the date of the notice.

- We have implemented a variety of mechanisms to stop the growing use by criminals of deceased individuals' identity information to perpetrate tax fraud. We routinely lock accounts of deceased taxpayers, and have locked more than 25 million accounts to date. Also, the Bipartisan Budget Act of 2013 included the Administration's proposal to limit public access to the Death Master File, which should further help to reduce identity-theft related tax fraud.

- We have developed better procedures to use information about identity theft victims received from law enforcement officials who discover this information in the course of investigating identity theft schemes or other criminal activity. We use the data to flag taxpayer accounts and block returns filed by identity thieves.

- Another important part of protecting taxpayers' identities involves the IRS' Social Security Number (SSN) Elimination and Reduction program. Under that program, we eliminate or reduce the use of SSNs within our systems, forms, notices and letters where the collection or the use of the SSN is not necessary. To date, we have eliminated or reduced the use of SSNs on 70 different non-payment notices that we mail to taxpayers. Also, we recently began to deploy SSN masking on eight additional notices with an annual estimated volume of 36 million notices mailed to taxpayers who request installment agreement payments.

- The Treasury Department and the IRS are also in the process of finalizing proposed regulations (REG-148873-09) allowing persons that are required to furnish tax-related documents to taxpayers to use a truncated taxpayer identification number (TTIN) on the taxpayer's copy of any tax-related document. A TTIN includes the SSN and ITIN.

- We have developed procedures to better stop the processing of fraudulent returns from prisoners. In FY 2013, we stopped more than 163,000 fraudulent returns filed by prisoners, representing approximately $1.2 billion in refunds. We have been helped by a number of actions in this area, including the Bipartisan Budget Act of 2013, which gives the

Treasury Department the Social Security Administration (SSA) the authority to share its Prisoner Update Processing System (PUPS) data with Treasury. Additionally, the IRS has collaborated with the Federal Bureau of Prisons, as well as Departments of Correction (DOC) in states that choose to partner with us by establishing agreements for the IRS to share information with these partners that helps to identify and address non-compliant prisoner returns before any refunds are released and refer certain prisoners for prosecution of refund fraud. Our authority to share return information with prisons, made permanent in the American Taxpayer Relief Act of 2012, helps us with these efforts.

- We are collaborating with software developers, banks, and others to determine how we can better address identity theft and prevent federal monies from reaching the hands of identity thieves. For example, we established the External Leads Program for receiving leads from financial institutions that have agreed to participate in the program. In 2013, 286 institutions participated in the program, which resulted in 198,000 returned erroneous tax refunds totaling $574 million.

- To combat the fraudulent use of prepaid debit cards, the IRS has also established relationships with representatives of the prepaid access card industry. This has enabled us to leverage their security protocols designed to detect and prevent fraudulent use of prepaid cards. In many cases, these companies can identify potentially fraudulent tax refunds and freeze or cancel the cards.

The IRS' current fraud detection capability is strong but limited by our current funding levels. Our significantly improved refund fraud system, the Return Review Program (RRP), has had its development delayed due to funding constraints. If fully deployed, the program would make it much easier for us to adjust our filters during the filing season as new schemes appear. Despite the delay in developing RRP, we continue to use computer systems like the Electronic Fraud Detection System (EFDS) to combat identity theft. EFDS performs well in providing protections to taxpayers and the tax system, but it is a rigid system that cannot be easily updated during filing season. We also use our Dependent Database (DDb) system to identify identity theft returns. The DDb system is flexible, and we are able to program new filters quickly as we identify new schemes. So far this year, we have stopped more than 900,000 potential identity theft returns through DDb.

We will continue to improve our identity theft identification and prevention program in filing season 2015. Our budget request includes an initiative that provides the staffing and advanced technologies required to support the increased workload. The components of our initiative include assisting victims of identity theft; expanding the criminal investigation identity theft clearinghouse that processes identity theft leads; and investing in information technology projects that will protect taxpayer information, help verify potentially fraudulent identity theft tax returns, and reduce erroneous payments. Our plans include obtaining the SSA's PUPS data to help reduce prisoner-related tax fraud and continuing development of RRP to the extent that our funding situation allows.

Even with the progress we have made and continue to make in the battle against refund fraud, I have asked our senior leadership team to reevaluate everything we are doing and to consider additional steps we could take to reduce refund fraud. As discussed later, this will require some assistance from the Congress with regard to legislative changes.

Assisting victims

Being victimized by identity theft is a frustrating, complex situation. The IRS has 3,000 people working directly on identity theft-related cases – more than double the number in late 2011. And we have trained 40,000 employees who regularly work with taxpayers to help with identity theft situations when they arise.

Critical to the IRS' efforts to assist identity theft victims is our Identity Protection Specialized Unit, which provides taxpayers with a single point of contact at the IRS via a special toll-free telephone line. We also have several identity theft specialized groups to assist with processing identity theft cases.

During FY 2012, the IRS reengineered its identity theft process to close cases more efficiently, accurately and in a less burdensome manner. In FY 2013, taxpayers who became identity theft victims had their situations resolved in roughly 120 days, far more quickly than in previous years when cases could take over 300 days to resolve. While this marks a significant improvement, we are continuing to work to find ways to shorten this time and ease the burden identity theft places on these victims. In CY 2013, the IRS worked with victims to resolve and close approximately 963,000 cases. So far in CY 2014, more than 368,000 cases have been closed and our backlog has been reduced from 204,000 cases last year at this time to 121,000 cases now.

Investigating fraud-related crimes

The investigative work done by the IRS is a major component of our efforts to combat tax-related identity theft. IRS Criminal Investigation (CI) investigates and detects tax and other financial fraud, including fraud related to identity theft. CI recommends prosecution of refund fraud cases, including cases involving identity theft, to the Department of Justice.

So far in FY 2014, CI has opened more than 821 new investigations into identity theft and refund fraud schemes, bringing the total number of active cases to more than 1,900. In addition, there have been 731 recommendations for prosecution and 555 sentences so far this year, with an average time to be served of more than 43 months. Our intensified activity in the criminal investigation area in relation to identity theft-related refund fraud follows a surge in the number of investigations opened in the last two years – 900 in FY 2012 and 1,500 in FY 2013.

State and local law enforcement agencies also play a critical role in fighting identity theft. CI regularly collaborates with these agencies, and, in March 2013, the IRS announced the nationwide expansion of the Law Enforcement Assistance Program, which began as a pilot program in Florida in 2012. This program provides for the disclosure of federal tax returns and return information associated with the accounts of known and suspected victims of identity theft when the victim provides express written consent for disclosure. To date, more than 5,900 waivers have been provided in 47 states.

One excellent example of our collaborative work with state and local law enforcement in the area of identity theft involves CI's participation in the Tampa Bay Identity Theft Alliance. Formed in July 2012, the Alliance comprises 20 federal, state and local law enforcement agencies and prosecutors in Florida's Tampa Bay area. As part of the Alliance, CI has sworn in more than 30 state and local law enforcement investigators as "Special Detailed IRS-CI Criminal Investigators," commonly referred to as Task Force Officers. CI has also provided these investigators training and additional prosecutorial tools available to federal law enforcement. In the Alliance's first year alone, cooperation among its members led to the arrest and subsequent indictment of numerous individuals who were attempting to perpetrate identity theft-related tax fraud. For example, the Tampa field office had more than 100 indictments in FY 2013 alone. Overall, the Alliance has prevented millions of dollars from being diverted to these criminals.

Many Florida law enforcement personnel have publicly noted the Alliance's accomplishments. For example, Jane Castor, the chief of the Tampa Police Department, said the Alliance "has made tremendous progress in combating tax fraud by fast-tracking the investigations and prosecution of cases," which sends "a strong message to offenders that committing tax fraud in Tampa will result in lengthy federal prison sentences." In addition, last year the Alliance was recognized as the "2013 Task Force of the Year," by the International Association of Financial Crimes Investigators. This is a national award given for investigative excellence and outstanding public service.

Improvements to the ITIN Program

ITINs may be used in the filing and collection of taxes from foreign nationals, resident and non-resident aliens, and others who have filing or payment obligations under U.S. law but who do not qualify for an SSN. The IRS has taken steps to improve the process of issuing ITINs in order to verify the applicant's identity and foreign status. We will continue to strengthen our efforts in this critical and complex area.

Last week, the IRS announced that ITINs will expire if not used on a federal income tax return for five consecutive years. The new, more uniform policy applies to any ITIN, regardless of when it was issued. Only about a quarter of the 21 million ITINs issued since the program began in 1996 are being used on tax returns. The new policy will ensure that anyone who legitimately uses an ITIN for tax purposes can continue to do so, while at the same time resulting in the likely eventual expiration of millions of unused ITINs.

ITIN application process

Under procedures in place since last year, the IRS, with few exceptions, only issues ITINs to taxpayers and dependents who provide original documentation, such as passports and birth certificates, or copies of these documents certified by the issuing agency, to verify their identity. These procedures also include tighter requirements for becoming a Certifying Acceptance Agent (CAA) and remaining in the CAA program. CAAs play an important role in the ITIN application process as intermediaries who review identity documents of the applicant. Under the tighter requirements, CAAs must certify to the IRS that they have verified the authenticity of the original or issuing agency-certified documents supporting the ITIN application. CAAs are also now required to undergo forensics training, and the IRS has begun compliance reviews of CAAs.

The IRS has also begun flagging ITIN applications containing characteristics of questionable traits at the time of input. This action, which is discussed in more detail below, will provide greater assurance that fraudulent applications are identified and stopped. We will prepare a risk assessment that, in addition to determining the scope and costs of programming, will address other mitigating controls that we can implement if the requested programming changes are not funded.

Investigating and detecting ITIN fraud

Reducing refund fraud involving the misuse of ITINs, in which individuals use ITINs to file returns claiming tax credits to which they are not entitled, continues to be a priority for the IRS, and we have made important progress in this area. Our CI division has increased investigative time spent on ITIN investigations by approximately 400 percent since 2008. Between 2008 and June 15, 2014, CI identified approximately 2,733 ITIN schemes that encompassed more than 323,700 returns with ITINs. Several fraud detection filters are in place specifically to help detect issues with the Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC).

Notably, last year the IRS detected specific patterns indicating potential fraud in returns with ITINs and was able to develop filters on a real-time basis during the filing season to stop these refunds from being issued. In addition, we have developed new methods of clustering suspicious returns together to catch large numbers of returns that appear similar. These clusters include identifying multiple returns using the same address or the same filing and refund patterns.

Strengthening Tax Compliance in Regard to Refundable Credits

Refundable tax credits play an important role in fulfilling Congressional policies, but they are subject to a number of tax administration challenges. There are numerous refundable credits currently administered by the IRS, including the EITC, the CTC, and the American Opportunity Tax Credit (AOTC). As stated above, the IRS has a dual mission when it comes to administering refundable credits. We must balance the mandate to get refunds out as quickly as possible to those who qualify with the need to ensure that the money goes only to individuals who are eligible to receive it.

There are a number of factors that present challenges to our compliance efforts as they relate to refundable credits. They include the following:

- *Complexity*. Complexity in the rules governing eligibility for and the operation of certain refundable credits creates challenges for both taxpayers and the IRS. Mistakes in the application of the law cause a significant portion of claims that are made in error.

- *Lack of Third-Party Data*. In many cases, the IRS lacks third-party data sources that could be used to verify taxpayers’ eligibility. Even if data exists, the IRS is often in the position of having to process returns and determine the validity of a refund claim before receiving the third-party data that could be matched against the return to verify information on the return. For example, Form 1099 information returns, which help the IRS determine a taxpayer's compliance with federal tax obligations, are generally due to the IRS by March 31 when filed electronically, which is after the time most refunds are processed. This problem could be partially addressed by enacting the Administration’s FY 2015 budget that would accelerate the filing due date for certain information returns, as discussed below.

- *Cash Payments*. Refundable credits allow for payments beyond income tax liability. This makes refundable credits particularly enticing targets for certain types of fraud.

Given these challenges, the IRS has dedicated significant attention and resources to improving tax compliance in regard to claims made for refundable credits in order to reduce improper payments. One of the biggest enforcement priorities for us in this area is the EITC.

Enforcing EITC rules

Congress created the EITC as part of the Tax Reduction Act of 1975, in part to offset Social Security taxes. The credit has evolved into an important program that now lifts millions of children and families above the poverty line each year.

To qualify to claim the EITC, individuals generally must: have earned income; have a valid SSN for themselves and for each qualifying child they claim; meet certain limits on filing status and income; have investment income of no more than a certain amount; and be a U.S. citizen or resident alien for the entire year for which the credit is claimed.

The amount of the EITC that an individual may claim varies based on whether the individual has any qualifying children, and if so, the number of qualifying children that the individual is able to claim. For a child to be considered a qualifying child, the following tests must be met:

- *Age:* The child must be under age 19 at the end of the year (under age 24 in the case of a student) and younger than the taxpayer (or younger than both the taxpayer and the taxpayer's spouse if filing a joint return), or the child must be permanently and totally disabled at any time during the year for which the EITC is claimed;

- *Residency:* The child must have lived with the taxpayer for more than half of the year for which the credit is being claimed, although certain exceptions to this rule apply; and

- *Relationship*: The child must be the taxpayer's son, daughter, stepchild, eligible foster child, brother, sister, stepbrother, stepsister, or a descendant of any of these individuals, such as a grandchild, niece, or nephew. Adopted children also qualify, including those lawfully placed with the taxpayer for legal adoption.

In addition, a taxpayer claiming the credit cannot be the qualifying child of another taxpayer, and cannot use the "married filing separately" filing status. Additional requirements apply for individuals who do not have qualifying children. Given the complex nature of the rules governing eligibility, the IRS engages in significant education and outreach efforts so that taxpayers are aware of their potential eligibility for the credit.

Our research has determined that most of the errors made by individuals claiming the EITC fall into three main categories. The largest group in terms of erroneous dollars claimed involves instances where an individual claims as a qualifying child a person who fails to meet one or more of the requirements described above. The second-largest group of errors, in terms of dollars claimed, involves income misreporting, and the third largest group involves individuals who incorrectly claim the “single” or “head of household” filing status when they should have used the “married filing jointly” or “married filing separately” filing status.

The IRS’ EITC-focused enforcement programs currently protect approximately $4 billion annually. The following programs contribute to the broader strategy of identifying improper EITC refund claims as early in the process as possible:

- *Math error*. This refers to an automated process in which the IRS has been granted statutory authority to identify certain math or other computational errors on the return and automatically adjust the return for a taxpayer. For example, math error procedures can be used to disallow or adjust EITC claims when there is a missing or incorrect SSN for a child used to qualify for EITC.

- *Document matching*. This process involves comparing income information provided by the taxpayer with information from third-party returns, such as Form W-2 and Form 1099, to identify discrepancies. For example, through document matching, the IRS may identify discrepancies in income reporting, which can impact EITC eligibility. The IRS conducted almost one million of these reviews in FY 2013, in addition to 500,000 audits.

- *Examinations*. The IRS identifies tax returns and amended returns for examination and in most cases holds the EITC portion of the refund until an audit can be completed. Of the approximately 500,000 EITC audits conducted by the IRS each year, 70 percent are conducted before the EITC portion of the refund is paid. The tax returns to be examined are selected using an effective risk-based audit selection model, resulting in changes to more than 90 percent of returns. Examinations protect almost $2.1 billion against improper EITC refund claims each year.

- *Soft notices*. The IRS uses what is commonly called a soft notice as a low-cost alternative to audits and an inexpensive way of recovering payments. Contrary to a statutory notice of deficiency, which provides the taxpayer with the right to appeal to Tax Court when the IRS is making an assessment to the taxpayer's account, soft notices are non-statutory reminders to comply. They serve as notification to the taxpayer that the IRS is reviewing their compliance, and they encourage the taxpayer to self-correct their tax return before an assessment is made by the IRS. In FY 2013, the IRS sent more than 110,000 letters to alert taxpayers that an exemption or qualifying child for the EITC claimed on their returns had also been claimed by another person.

- *Two- and 10-year bans*. Under section 32(k), the IRS is authorized to ban taxpayers from claiming the EITC for two years if it determines during an audit that they claimed the credit improperly due to reckless or intentional disregard of the rules. The IRS can impose a 10-year ban in cases of fraud. When a ban is imposed, taxpayers are provided their full appeal rights to challenge the ban. Last year there were more than 67,000 two-year bans and 45 10-year bans in effect.

The IRS continues working to improve and expand its existing compliance efforts to stop improper EITC payments. Notably, our increased efforts in regard to identity theft-related fraud detection have helped improve EITC enforcement results.

In spite of these accomplishments, it is important to note the significant degree of difficulty in enforcing compliance with the EITC, which derives in large part from its eligibility requirements. EITC eligibility depends on complex rules that may be difficult for taxpayers to understand and on items that the IRS cannot readily verify through third-party information reporting, including marital status and the relationship and residency of children. In addition, the eligible population for the EITC shifts by approximately one third each year, making it difficult for the IRS to use prior-year data to assist in validating compliance.

Given this situation, and given that approximately 57 percent of the returns claiming the EITC in recent years are prepared by tax return preparers, we believe that one of the keys to driving increased EITC compliance continues to be strategic programs addressed to the return preparer community. Examples of our preparer-related activities include: compliance and warning notices sent before and during the filing season to preparers who prepare large numbers of EITC returns to educate them on their responsibilities and the consequences of noncompliance; preparer audits done by field examiners to make sure preparers are complying with EITC due diligence rules; and “knock-and-talk” visits to preparers by CI agents and auditors, to educate them on EITC laws.

Additionally, the IRS has expanded its traditional treatment of EITC preparers to test a new early-intervention program. Over the last few years, the IRS has employed data analytics to significantly reduce improper payments associated with the EITC, as well as the CTC. Using this approach, the IRS ran a small data-driven pilot in 2012 to identify a group of tax return preparers with a history of submitting incorrect or potentially fraudulent tax returns falsely claiming the EITC, then designed and implemented interventions with these preparers to stop improper claims. The interventions included letters, calls, and site visits to selected preparers, both before and during tax filing season, to allow preparers to immediately adjust their practices.

An expanded preparer pilot in 2013 included a broader set of randomly selected preparers and a broader set of interventions, including the addition of preparerfocused taxpayer audits (for returns that otherwise would have qualified for audit even absent the pilot). Many preparers whose error rates did not improve as a result of interventions during the 2012 pilot did improve in 2013 after being subject to additional intervention. Preparers who had improved due to IRS interventions during the initial 2012 pilot generally maintained their improved compliance with respect to EITC and related tax credits claimed on returns and claims filed during 2013.

Use of interventions for preparers before and during the filing season continued on an expanded basis in 2014. Since this approach has been used, improper EITC payments have been reduced by more than $1.5 billion over three years for returns prepared by preparers who received the interventions.

In addition to these specific preparer-related EITC programs, the IRS has looked at return preparer compliance more broadly. Beginning in 2010, anyone who prepares all, or a substantial portion of, a federal tax return for compensation must register with the IRS, obtain a Preparer Tax Identification Number (PTIN) which they include on returns they sign, and renew their registration each year. Since 2010, more than a million individuals have registered with the IRS, and we currently have more than 680,000 return preparers active in our PTIN database.

PTINs assist our enforcement efforts by allowing the IRS to collect more-accurate data on who is preparing returns, the volume and types of returns being prepared, and the qualifications of those doing return preparation. Additionally, PTIN data is essential in determining where to direct compliance and educational outreach efforts for erroneously prepared tax returns.

Basic competency for paid tax return preparers is also essential for accurate return preparation. Currently, about 60 percent of tax return preparers operate without any type of oversight or education requirements. In the FY 2015 Budget, the Administration proposed that Congress provide the Treasury Department and the IRS with legislative authority to regulate tax return preparers, which is a proposal discussed in more detail below. Until legislation is enacted, the Treasury Department and the IRS have established an Annual Filing Season Program designed to encourage tax return preparers who are not attorneys, certified public accountants (CPAs), or enrolled agents (EAs) (in other words, not credentialed preparers) to improve their knowledge of federal tax law. An unenrolled tax return preparer who successfully completes continuing education, including a six hour federal tax law refresher course with a test, will receive an Annual Filing Season Program – Record of Completion from the IRS. They will also be included in a database with credentialed preparers on IRS.gov that will be available by January 2015 to help taxpayers determine return preparer qualifications during the 2015 filing season.

This Annual Filing Season Program will be an interim step until legislation is enacted to help protect taxpayers during the 2015 filing season and to help ensure more accurate return preparation and improved tax compliance. Despite all of the efforts described above, we continue to be concerned that the improper payment rate for the EITC has remained unacceptably high throughout the program's history. (For FY 2013, the EITC improper payment rate was between 22 and 26 percent.) Therefore, we recently initiated a major review of our activities in this area. As part of this review we are assessing our many past and current efforts and are exploring new possibilities, such as finding more-efficient ways to distinguish valid claims from excessive claims. We also believe that enactment of the legislative proposals presented next will play a critical role in our effort to lower the EITC improper payment rate.

Administration's Legislative Proposals

Congress can help us further enhance our efforts to reduce improper payments, particularly those involving the EITC, by approving a number of legislative proposals contained in the Administration's FY 2015 Budget, including the following:

- ***Correctible error authority***. As noted above, the IRS has limited statutory authority, known as "math error authority," to identify certain computation or other irregularities on returns and automatically adjust the return for a taxpayer. These upfront systemic processing checks protect approximately $320 million in improper EITC payments annually. At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific newly enacted tax code amendments. The Administration's proposal would replace the existing specific grants of this authority with more general authority covering computational errors and incorrect use of IRS tables. Further, the proposal would expand IRS' authority 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 government databases. Without correctible error authority, any obvious errors in a return can only be fixed after an audit, which requires far more resources than we presently have. The result is improper payments are not stopped or collected.

- ***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 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 Administration's proposal would require information returns to be filed with the IRS (or SSA, in the case of Form W-2) by January 31, except that Form 1099-B would have to be filed with the IRS by February 15. The proposal would also eliminate the extended due date for electronically filed returns.

- ***Authority to regulate return preparers.*** In light of the recent court decision striking down the IRS' authority to regulate unenrolled and unlicensed paid tax return preparers, the Administration's proposal would explicitly authorize the IRS to regulate all paid preparers. The regulation of all paid preparers, in conjunction with diligent enforcement, will help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. Significant harms to the tax system are caused by incompetent and dishonest preparers, including increased collection costs, reduced revenues, the burden placed on taxpayers by the submission of incorrect returns on their behalf, and a reduction in taxpayers' confidence in the integrity of the tax system.

- ***Due diligence***. Return preparers who prepare tax returns on which the EITC is claimed must meet certain due diligence requirements to ensure their clients are in fact eligible to receive this credit. In addition to asking questions designed to determine eligibility, the preparer must complete a due diligence checklist (Form 8867) for each client and file the checklist with the client's return. The Administration's proposal would extend the due diligence requirements to all federal income tax returns claiming the CTC and the ACTC. The existing checklist would be modified to take into account differences between the EITC and CTC.

There are a number of other legislative proposals in the Administration's FY 2015 Budget request that would also assist the IRS in its efforts to combat identity theft. One of the most significant would be to amend the Social Security Act to expand IRS access to information in the National Directory of New Hires for individual income tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for non-compliant taxpayers, and identification of levy sources.

Other legislative proposals in the Administration's FY 2015 Budget request that would assist the IRS in its efforts to combat identity theft include the following: giving Treasury and the IRS authority to require or permit employers to mask a portion of an employee's SSN on W-2s, an additional tool that would make it more difficult for identity thieves to steal SSNs; adding tax-related offenses to the list of crimes in the Aggravated Identity Theft Statute, which would subject criminals convicted of tax-related identity theft crimes to longer sentences than those that apply under current law; and adding a $5,000 civil penalty to the Internal Revenue Code for tax-related identity theft cases, to provide an additional enforcement tool that could be used in conjunction with criminal prosecutions.

III. CONCLUSION

Chairman Mica, Ranking Member Connolly and members of the Subcommittee, thank you again for the opportunity to discuss our efforts to reduce improper payments, in particular as they relate to refund fraud, misuse of ITINs and erroneous claims for refundable tax credits. I remain concerned about our ability to continue to make progress in all of these areas in light of our ongoing difficult budget environment. I believe it is vital that we find a solution to our budget problem, so that the IRS can be on a path to a more stable and predictable level of funding. I look forward to working with Congress and this Committee to do just that. This concludes my statement, and I would be happy to take your questions.