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PRIVACY, GOVERNMENTAL
LIAISON AND DISCLOSURE

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

July 21, 2020

This is a final response to your Freedom of Information Act (FOIA) request dated May 26, 2020 that we received on May 26, 2020.

You asked for A copy of the Questions For the Record (QFR) and agency QFR responses to Congress responding to QFRs during calendar years 2017, 2018, 2019 and 2020 to date, for the IRS.

I am enclosing a copy of the requested records consisting of 249 pages. This is a full grant of your request.

You may contact the FOIA Public Liaison, Summer Sutherland at (801) 620-2149, to discuss your request.

The FOIA Public Liaison responds to FOIA and Privacy Act requests for copies of documents maintained by the IRS. There is no provision in either Act to resolve tax, collection, or processing issues and our staff is not trained to answer questions regarding those issues. If you need assistance with tax related issues you may call the IRS toll free number at 1-800-829-1040.

If you have any questions please call me, ID # 1000591343, at 617-316-2271, or write to: Internal Revenue Service, Centralized Processing Unit – Stop 211, P.O. Box 621506, Atlanta, GA 30362. Please refer to case number F20147-0037.

Sincerely,

A handwritten signature in black ink, reading "David S. Nimmo".

David S Nimmo
Disclosure Manager
Disclosure Office 13

Enclosure
Responsive Records

HOCR Hearing - Ongoing Management Challenges at IRS

Representative Hice

With the recent Equifax data breach, there is more and more personally identifiable information available for criminals to use when filing fraudulent returns.

1. Can the IRS create a "refund lock" option for taxpayers' Future State personnel accounts? The application could allow taxpayers to permanently apply any refund they might receive toward the following year's tax payment - until they went back and expressly "unlocked" it. This would render their information useless to criminals trying to file fraudulent returns. Taxpayers could theoretically leave their refund locked all year and then if they want their refund at filing season, they simply go back into their accounts and unlock them for a short period of time. Once the refund is in the bank, they relock their accounts.

We are currently exploring options, which would allow taxpayers the ability to lock their personal online accounts, similar to what you describe. The options we are considering, however, are not focused on whether there is a refund. The focus is providing the taxpayer an option to self-initiate an account lock, if the taxpayer is concerned about the potential for tax related identity theft, suspected fraudulent activity, or whether their account will be used to e-file a false return.

One solution we're exploring is an online account lock/unlock feature. This would allow taxpayers to self-initiate a lock of their online account and trigger processes to validate (re-authenticate) their account. This option would prevent additional online transactions and provide self-initiated protections to the online account.

Another solution we're exploring is an at-filing lock/unlock feature. This would allow a taxpayer to initiate a lock to prevent the submission of an electronically filed (e-File) return. In addition, the lock will prevent the electronic acceptance of the return if the taxpayer, spouse or dependents' social security number is presented on an electronically filed return while the lock is in place. The premise is to provide taxpayers control of their account with the IRS and prevent e-filing activity until they are ready to file their return. When the taxpayers are ready to file, they will unlock their accounts and provide return information to electronically file their returns.

Both solutions are in the very early stages of development. We will continue to consider ways to address this issue.

Note that current law allows taxpayers to elect to apply their tax refund to the following tax year's tax liability through the estimated tax process. We monitor these estimated tax payments to identify potential fraudulent activity.

2. Is this a viable idea, and is this something that the IRS is considering?

A refund lock option that would permanently prevent refunds unless the taxpayer unlocks the account is not a solution we are pursuing because:

- Under Internal Revenue Code (IRC) section 6611, we are required to pay interest on overpayments. Under this section, when a taxpayer files a timely, processible return, interest generally accrues on overpayments that are not refunded within the later of 45 days of filing or 45 days from the due date of the return. Therefore, the overpayment may accrue interest depending on when a taxpayer “unlocks” their refund, potentially creating additional cost to the government unless the taxpayer opts for a credit election or the refund is used for a payment offset. Furthermore, statutory changes would be required if this option is intended to apply to any type of tax other than income tax. Under IRC section 6402(b), income tax overpayments can be credited to the subsequent year’s estimated tax payments, but IRC section 6402(a) provides no generalized right for taxpayers to carry overpayments forward against future projected tax liabilities. Under the current statute, an election to credit an overpayment to the subsequent year’s estimated tax must be made every year. No interest is allowable on an overpayment that is credited to a subsequent year’s estimated tax.
- A refund lock that requires taxpayer action to have a refund issued rather than being applied to the following year’s tax liability would likely only help a small segment of taxpayers and would burden a larger segment of taxpayers who rely on actually receiving their refunds every year. For example, taxpayers claiming refundable credits or in lower income brackets are more likely to need refunds at the time of filing and would not choose to freeze or carryover refunds to a future year. Though a refund lock could be helpful to taxpayers who make estimated payments, only about 16 million of 140 million returns filed this year included estimated tax payments.
- A refund lock places additional burden on taxpayers to track their refunds and increases the risk of unclaimed refunds over time.

We believe the solutions we are exploring, described in the response to question one, are better options to protect taxpayers from tax-related refund fraud. We take our responsibility to protect sensitive data seriously and continuously evaluate solutions in a changing environment to ensure the integrity of the tax system. We are committed to doing all that we can to prevent the payment of fraudulent refunds, pursue the perpetrators, and assist the victims.

Questions for the Record
May 3, 2017, hearing titled "Reviewing the FAFSA Data Breach" before the House
Committee on Oversight and Government Reform

Questions for Ms. Gina Garza, Chief Information Officer

Questions from Chairman Jason Chaffetz

- 1. The written testimony of Deputy Inspector General Camus states that the "same individuals and groups engaging in criminal activity on the e-Authentication portal are involved in this exploit of the FAFSA and the DRT." When were you first made aware of the connection between the two hacks?**

In early March 2017, after detecting potentially criminal activity, the IRS and the Department of Education temporarily suspended access to the Federal Student Aid – Datashare (FSA-D) Data Retrieval Tool (DRT). We first learned about the potential connection between the criminal activity on the DRT and the e-Authentication portal when we received the written testimony from the Treasury Inspector General for Tax Administration (TIGTA) on May 2, 2017.

- a. Do you agree with the IG's assessment?**

We have not yet concluded that the same perpetrators participated in the e-Authentication and DRT incidents. Our research indicates that perpetrators tried to file fraudulent returns using data they got from the DRT. Since we are still reviewing these returns, we cannot confirm that they are fraudulent.

- 2. The written testimony of Deputy Inspector General Camus states that "In September 2016, TIGTA detected an attempted access to the AGI of a prominent individual. When we investigated the attempted access, we determined that the FAFSA application and the DRT were used in this attempt."**

- a. Did you alert the "prominent individual" that their personally identifiable information had been compromised? If not, why not?**

In September 2016, our systems detected and prevented a perpetrator from accessing the Adjusted Gross Income (AGI) of a prominent individual using public or illegally obtained personally identifiable information. After analyzing the incident, we determined that the perpetrator did not get the taxpayer's personally identifiable information from IRS systems. Since we only notify taxpayers if their personally identifiable information has been compromised because of a system breach or we made an unauthorized disclosure, we did not alert the individual.

b. In the wake of the September 2016 incident involving the "prominent individual" did you identify the fraudulent pattern of use of the FAFSA or the DRT to the Department? If not, why not?

Based on our analysis, the September 2016 incident was an isolated attempt to gain access to the individual's tax information. We did not identify a fraudulent pattern. After the incident, we added safeguards for Social Security numbers of high-profile taxpayer accounts in order to mitigate the risk of unauthorized access to their tax information.

However, for the DRT overall, when we discovered the potential DRT vulnerability in September 2016, we took immediate action by increasing monitoring and blocking IP addresses as a short-term solution. By January 2017 we had started working with the Department of Education to analyze longer-term solutions, which required changes to both the DRT and to the Department of Education applications. We agreed with the Department of Education that since we did not have any confirmed criminal activity we would monitor the DRT application, rather than shut it down immediately and thereby burden students applying for financial aid. But we advised the Department of Education that if we noticed an indication of identity theft, we would shut down the application.

c. Was there ever any consideration to notify Congress and/or federal law enforcement that the "prominent individual's" personally identifiable information had been compromised?

Federal law enforcement (i.e., TIGTA) notified us of the unsuccessful attempted access. No personal taxpayer data for the "prominent individual" was compromised, exposed, or disclosed by IRS systems. TIGTA maintains jurisdiction over the criminal investigation of this matter. We understand that TIGTA is conducting an ongoing criminal investigation into this incident.

Questions for Ms. Gina Garza, Chief Information Officer

Questions from Representative Will Hurd

- 1. The IRS dealt with Get Transcript in 2015 and the FAFSA incident this year. These incidents will occur in the future and will continue to hurt taxpayers and our ability to invest in critical services like our military and care for veterans. To help prevent future issues, is the IRS investing in proven commercial technology that can examine tax, cyber, and external data securely, quickly, and at scale? Or is it continuing to rely on in house systems that have failed in the past?**

Securing taxpayer services and associated data is one of our highest priorities. We have invested in the use of proven commercial technologies for the examination of tax, cyber, and external data to prevent and detect fraudulent activity, as well as worked with our partners at the US Digital Service, and will continue to do so. We have strengthened protection and detection for FSA and DRT, and are working on expanding coverage to all affected services.

Questions for the Record
May 3, 2017, hearing titled "Reviewing the FAFSA Data Breach" before the House
Committee on Oversight and Government Reform

Questions for Mr. Kenneth C. Corbin, Deputy Commissioner, Wage and Investment Division

Questions from Representative Robert C. "Bobby" Scott

- 1. By automatically populating income information, the IRS Data Retrieval Tool (DRT) helps two types of individuals: 1) students who are filling out their Free Application for Federal Student Aid (FAFSA) and 2) borrowers who are enrolling or re-enrolling in an income-driven (IDR) repayment plan.**

According to the most recent data available through Federal Student Aid, more than eight million students apply for financial aid between April 1st and September 30th-the same timeframe that the DRT is expected to be unavailable. While many high school students have already submitted FAFSA applications, the DRT shutdown disproportionately affects community college students - many of whom are low-income and older students.

Given that we are now past the deadline for individuals to file their tax returns, is there a way for the IRS to mitigate the risk of the vulnerability of the DRT in such a way that the tool could become available for use by FAFSA filers now until the encryption solution is deployed?

While we recognize the important role the DRT serves in helping students apply for financial aid and enroll in, or maintain eligibility for, income-driven repayment plans, protecting taxpayer information is our highest priority. We have been working closely with the Department of Education to safely return the DRT to service as soon as possible. Students and families should plan for the tool to be offline until the start of the next FAFSA season when extra security protections to the program can be added. However, we restored the IRS DRT for the income-driven repayment (IDR) plan application on StudentLoans.gov on June 2, 2017.

It should be noted that we explored the possibility of returning the DRT to service using alternate technical mitigations. We decided, however, that these mitigations would not sufficiently reduce the risk of fraud and would require resources that would otherwise be put toward the encryption solution.

While the DRT for FAFSA is unavailable, the FAFSA applications are still available and operable. The income information needed to complete the FAFSA can be found on a previously filed tax return. Applicants who have not retained a copy of their prior year tax return can obtain a transcript of their account using the Get Transcript application on

IRS.gov. When using Get Transcript Online, registered users will receive the transcript immediately. If using Get Transcript by Mail, it will take an average of 5-10 calendar days to receive the transcript.

- 2. My understanding is that the IRS recently introduced strengthened authentication processes for its electronic "Get Transcript" application, which provides tax filers on-line access to key data from their tax returns. However, I have heard that successful authentication requires users to have a mortgage, a car loan, or a credit card, and a cell phone in their own name. These requirements seem to be a barrier for many users, especially from low-income families.**

In order to use Get Transcript, tax filers must successfully authenticate their identity through Secure Access. We designed the Secure Access e-authentication solution to comply with OMB Memorandum M-04-04¹ and National Institute of Standard and Technology (NIST) Special Publication 800-63r2² Level 3 assurance guidelines, which significantly increase the rigor to resolve the identity of a user as required for web applications requiring "High confidence in the asserted identity's validity" and requires multi-factor authentication techniques for web applications. In order to meet these guidelines, we incorporated financial verification into Secure Access e-authentication. The IRS considered several options, and determined that we could consistently confirm through record checks, account numbers for a credit card, home mortgage loan, home equity (or second mortgage) loan, home equity line of credit (HELOC), or car loan. A credit bureau provided a representative sample of its user population, which demonstrated that 80% had credit cards, 57% had auto loans, 68% had a mortgage, and 63% had a home equity loan. As a result, we determined that we could reasonably confirm the taxpayer identities while adhering to NIST guidance. We continue to look at ways of increasing access to our online tools for all taxpayers, including low-income individuals, while maintaining appropriate levels of security.

a. Can you please explain what families need to use the "Get Transcript" application?

To use Get Transcript, tax filers must complete the Secure Access process. Although returning users can log in with an existing username and password and a security code sent by text to a mobile phone, new users need the following:

- An email address;
- Social Security number (SSN);
- Filing status and address from last-filed tax return;
- Personal account number from one of the following:
 - credit card,
 - home mortgage loan,
 - home equity (second mortgage) loan,

¹ Available at <https://georgewbush-whitehouse.archives.gov/omb/memoranda/fy04/m04-04.pdf>.

² Available at <http://nvlpubs.nist.gov/nistpubs/SpecialPublications/NIST.SP.800-63-2.pdf>.

- home equity line of credit (HELOC), or
- car loan
- A U.S.-based mobile phone. The user's name must be associated with the mobile phone account.
- If applicable, temporary removal of a "credit freeze" on the user's credit records through Equifax.

We do not retain the user's financial account information.

To complete the process, new users must:

- Submit their name and email address to receive a confirmation code;
- Enter the emailed confirmation code;
- Provide SSN, date of birth, filing status, and address on the last filed tax return;
- Provide financial account information for verification from the above list;
- Enter a mobile phone number to receive a six-digit activation code via text message or request an activation code by mail;
- Enter the activation code; and
- Create a username and password, create a site phrase, and select a site image.

b. Do certain users, such as low income individuals, have a tougher time getting access?

We take seriously our responsibility to secure taxpayer data in order to protect taxpayers from identity theft and prevent cyber criminals from accessing government revenue through refunds.

Our demographic data analysis indicates that lower income taxpayers do not complete the Secure Access steps as often as taxpayers with higher income. This is in part because our security standards require financial verification, or a financial account, for identity verification. In order to increase broader access, the IRS provides two other options for a taxpayer to request and obtain a transcript: on the web by using Get Transcript by Mail, or via an automated self-service telephone application. Both options mail the transcript to the taxpayer's address of record. In this way, we ensure that taxpayers have multiple ways of obtaining their tax data through self-service options. We continue to look at ways of increasing access to our online tools for all taxpayers, including low-income individuals, while maintaining appropriate levels of security.

**QUESTIONS FOR THE RECORD
COMMITTEE ON WAYS AND MEANS
OVERSIGHT SUBCOMMITTEE
“IRS TAXPAYER AUTHENTICATION: STRENGTHENING SECURITY WHILE
ENSURING ACCESS”
SEPTEMBER 26, 2018**

Questions from Chairman Jenkins

- 1. During your testimony, you described that in 2015 the IRS established the Identity Assurance Office to help the IRS better understand authentication and fraud detection needs across the agency. The Treasury Inspector General for Tax Administration (TIGTA) and Government Accountability Office (GAO) as a part of their work on the IRS's authentication efforts have discussed a number of parties inside the IRS that provide input to aspects of the IRS' s authentication efforts. Please list (1) all entities within the IRS that are involved in decision-making and directing policy where online authentication is concerned, (2) how the various entities involved coordinate their activities within the IRS, and (3) the entity that ultimately is responsible for ensuring the success of the IRS's online authentication efforts.**

IRS Response to Question 1: The success of the IRS's online authentication efforts is a shared responsibility across many functions. The IRS has structured governance with respect to the online authentication by establishing the Authentication, Authorization, and Access (A3) Executive Governance Board (EGB). The A3 EGB governs selected investments and their systems, programs and projects, as delegated by the Services and Enforcement (S&E) Executive Steering Committee (ESC) and, as appropriate, the Information Technology (IT) Strategic Development (SD) ESC. Through this governance role, the A3 EGB supports Service-wide A3-related strategy execution by building and operating more consistent approaches for the A3 needs across IRS functions and programs. The A3 EGB provides concurrence, guidance, and information sharing on A3 priorities, risks, strategic direction, and resource management. Policy guidance for the IRS's online authentication efforts resides with the S&E ESC.

- 2. During the hearing, you described that the IRS has put its most sensitive tools and applications behind Secure Access. Please discuss (1) how many individuals have successfully passed Secure Access' s multifactor authentication, (2) what was the Secure Access pass rate for individuals attempting to authenticate their identities in 2017 and 2018, and (3) how many tools and applications does the IRS plan to add to Secure Access in 2019.**

- a. Does the IRS currently have a goal for the percentage of taxpayers it would like to have success fully verify their identities through Secure Access?
- b. What other metrics does the IRS use to evaluate the accessibility of its online tools and applications?
- c. What options are available to legitimate taxpayers who fail the Secure Access authentication process but would still like to access the IRS' s online tools and applications behind Secure Access?
- d. The IRS' s Electronic Tax Administration Advisory Committee recommended in June 2018 that the IRS investigate the use of trusted third parties as an alternative to conduct in-person identity proofing to enable taxpayers to ultimately gain remote secure access to their information. To what extent does the IRS use or plan to use third parties for authentication services?
- e. Does IRS currently have any plans under way to develop other mobile applications, similar to IRS2GO? If so, please discuss those mobile applications.
- f. To what extent does the IRS have plans to develop and implement an online third- party authorization tool that would supplement the processing of paper copies of IRS Forms 2848, Power of Attorney and Declaration of Representative and Form 8821, Taxpayer Information Authorization?

IRS Response to Question 2(1): Secure Access's multifactor authentication has had 6.5 million taxpayers register as of September 30, 2018.

IRS Response to Question 2(2): The Secure Access multifactor authentication verification rate for fiscal year 2017 was 33.3% and for fiscal year 2018 it was 39.2%.¹

IRS Response to Question 2(3): The IRS currently has no plans to add additional applications to Secure Access in fiscal year 2019, with the possible exception of a tax professional account as described in response 2(f) and pending further solution design activities. The IRS has an online account for individual taxpayers and increases the functionality of that system using its agile development program which allows the IRS to identify projects and then develop new functionality on a nine-week cycle. While this is not a new FY 2019 application, the IRS is following the best practices of industry and continuously improving the service provided to taxpayers by means of this existing online application. Additionally, the IRS plans to continue increasing security for select online applications protected by Secure Access during FY 2019.

IRS Response to Question 2(a): Our goal is to continuously improve the user experience and increase coverage while protecting taxpayer data and the security of the system. The percentage of taxpayers who successfully verify their identities through Secure Access is one of several indicators of both the security and usability of our taxpayer services.

IRS Response to Question 2(b): As part of the Authentication Strategy, the IRS has committed resources to systematically analyze the Secure Access user experience and use data analytics results to improve screen wording, user input fields, and error messaging. This analysis includes assessing the user experience by application, volume and user type (e.g. new, returning).

IRS Response to Question 2 (c): While taxpayers may always access their information using traditional customer-service channels (i.e., phone, in-person, by mail), some taxpayers who are unable to authenticate through Secure Access may be able to finish the process by mail and thereafter establish an online profile and use that profile to access their information online. Taxpayers who fail the initial IRS identity verification steps or the financial verification steps may only obtain services through other channels. In contrast, customers who satisfy the identify and financial verifications steps but who cannot register successfully because they do not have a phone or they failed the phone verification step may request an activation code by mail (sent to their mailing address of record) and may use that code to establish their online profile and thereafter use their profile to access their information online.

IRS Response to Question 2(d): The IRS appreciates this recommendation, which aims to help improve service to taxpayers. The IRS will develop requirements in accordance with the NIST SP 800-63C, *Digital Identity Guidelines: Federation and Assertions*, by the end of fiscal year 2019. Once the requirements are developed, the IRS will examine the feasibility of a short duration, limited scope innovation study to evaluate these requirements.

IRS Response to Question 2(e): IRS2Go is the official mobile app of the IRS and currently provides a platform for several online capabilities for taxpayers such as checking refund status, making a payment, finding free tax preparation assistance, signing up for helpful tax tips, and generating login security codes for certain IRS online services protected by Secure Access. Future mobile service options may be added based on taxpayer needs and other factors.

IRS Response to Question 2(f): The IRS is in the process of creating detailed requirements for a tax professional account. This concept has been vetted with tax professionals at IRS National Tax Forums and other venues. Delivery of the tax professional account feature is expected to require a high level of effort, and to mitigate

risk, the IRS will build and roll out these features in an incremental and iterative development process, similar to how the IRS implemented individual taxpayer online account -- incrementally and growing in capabilities over time. Future capabilities common to both the tax professional account and the taxpayer account will include digital equivalents of Form 2848 or 8821 used to establish representational or information access rights. Given the range of tax professionals and taxpayers that the IRS interacts with each day, it is expected that the IRS will continue to receive and process paper Forms 2848 and 8821 even after the IRS has developed and launched the tax professional account.

- 3. During the hearing, you discussed that the IRS is currently not compliant with the new National Institute of Standards and Technology (NIST) digital identity guidelines (SP 800-63-3), in particular the identity proofing component but the IRS has completed risk assessments.**
 - a. Does the IRS expect to fully comply with the 2017 NIST digital identity guidelines by the end of the 2019 filing season? If not, when does the IRS expect to fully comply with the new NIST digital identity guidelines?**
 - b. How many of the IRS's 52 tools and applications are currently operating below their assessed Identity Assurance Level (IAL) and Authenticator Assurance Level AAL)? Are any of those tools and applications with an IAL and/or an AAL of two or greater currently not behind Secure Access?**
 - c. What additional oversight or monitoring of the IRS' s online tools and applications does the IRS complete where there is a discrepancy between the assessed and implemented IAL and AAL?**
 - d. What mechanisms does the IRS have in place to coordinate with other agencies on their compliance with the NIST digital identity guidelines?**

IRS Response to Question 3: The IRS is committed to continuously improving our authentication procedures in line with guidelines from the Office of Management and Budget (OMB) and NIST, which apply to all federal agencies implementing digital identity services.

When NIST revised its guidelines in June 2017 with the release of NIST SP 800-63-3, it was a complete rewrite of the eAuthentication standard that created a new framework

for federal agencies to improve the security of their identity-proofing and authentication programs. The new guidelines introduced new concepts and redefined how federal agencies implement digital identity services. Further, the new standard has substantially more rigorous requirements than the previous standard.

The IRS is working to assess how the new guidelines affect the processes and systems that taxpayers use, and we have taken preliminary steps to implement the guidelines. For example, we developed a comprehensive, data-driven approach to assess applications against the new NIST guidelines and have begun testing the new process.

One of the first steps we took was to determine the extent to which existing applications might meet the new NIST standards. For example, we assessed the Secure Access system against the new NIST guidelines and we found the IRS meets Authentication Assurance Level (AAL) 2 and Identity Assurance Level (IAL) 1 requirements. However, like all federal agencies, the IRS faces challenges implementing the new NIST standards across all of our applications.

As we progress on implementing these new standards, we continue to safeguard taxpayer information through the implementation of strong mitigations and compensating controls to strengthen the overall security of online services. An example is enhancements to network monitoring controls to help block suspicious activity on IRS.gov and thus thwart cybercriminals' attempts to obtain unauthorized access to taxpayer data through our online applications.

We emphasize that the cyber landscape is consistently shifting, requiring stronger identity proofing and authentication requirements and robust cyber monitoring tools.

IRS Response to Question 3(a): The IRS is working to assess how the new guidelines affect the processes and systems that taxpayers use, and we have taken preliminary steps to implement the guidelines. We currently do not have an expected completion date, but work in this area is underway.

IRS Response to Question 3(b): Over the last several years, we have focused on strengthening our online identity proofing and authentication processes, and we have made significant progress. In our initial review, we believe many of our transactions will be assessed at AAL2 and we are fully compliant with AAL2. We anticipate completing comprehensive assessments on all externally-facing transactions by the fall of 2019. These assessments will help inform the extent to which IRS tools and applications have the proper identity proofing and authentication procedures in place. In parallel, we have partnered with the Department of the Treasury and the Social Security Administration to identify an "identity proofing solution" that meets the IAL level 1 and level 2 standards.

IRS Response to Question 3(c): Where necessary the IRS implements strong mitigations and compensating controls to strengthen the overall security of online transactions. These include additional technical and management controls, as well as other reasonable mitigations to safeguard taxpayer information. For example, with implementation of network monitoring capabilities, we now have the ability to get automated alerts based on anomalies detected.

IRS Response to Question 3(d): The IRS actively participates in recurring meetings and forums with the Treasury Department, Treasury Bureaus, the Social Security Administration, the NIST, the General Services Administration (GSA) and other stakeholders in this arena.

Questions from Rep. LaHood

- 4. For those online tools and applications where there is currently a discrepancy between the assessed IAL / AAL and implemented IAL / AAL, has the IRS developed plans to bring those tools and applications into alignment?**

IRS Response to Question 4: The IRS is assessing how the new guidelines affect the processes and systems that taxpayers use, and we are taking preliminary steps to implement the guidelines. Our goal is to ensure we use adequate security controls and where necessary, we implement strong mitigations and compensating controls to strengthen the overall security of online services. We do not currently have an expected completion date for bringing all tools and applications into alignment with the new NIST guidelines, but work in this area is underway.

- 5. When does the IRS expect full compliance between the assessed IAL/ AAL and implemented IAL/ AAL for all of its 52 online tools and applications?**

IRS Response to Question 5: The IRS is working to assess how the new guidelines affect the processes and systems that taxpayers use, and we have taken preliminary steps to implement the guidelines. We currently do not have an expected completion date for bringing all tools and applications into compliance with the new NIST guidelines, but work in this area is underway.

¹ Represents activity since the December 10, 2017 relaunch, (after the October – December 2017 temporary shut-down).

Questions for the Record

Complexities and Challenges of Social Security Coverage and Payroll Compliance for State and Local Governments

House Ways and Means Committee Subcommittee on Social Security and Subcommittee on Oversight

June 29, 2017

1. Sometimes payroll tax withholding problems can go back 10 or more years, what is the statute of limitations for correcting payroll tax withholding errors? How does the current statute of limitations affect the ability of the Internal Revenue Service (IRS) to recover lost payroll taxes?

The normal period of limitations for assessment of tax with respect to a tax return expires three years after the return is filed or due, whichever is later. See 26 U.S.C. § 6501(a) and (b)(1). The date that the period of limitations expires is also referred to as the “statute date.”

For certain employment tax returns, the statute date is based on a “deemed filing date.” Employment tax returns filed quarterly, such as Form 941, *Employer’s QUARTERLY Federal Tax Return*, must generally be filed by the last day of the month following the end of the quarter (for the quarter ending 3/31/17, the return would be due by 4/30/17). For the purpose of determining the period of limitations for assessments, a quarterly return filed for any of the quarters of the calendar year has a deemed filing date of April 15 of the succeeding calendar year, per 26 U.S.C. § 6501(b)(2). For example, the deemed filing date for Forms 941 for the quarters ending 3/31/17, 6/30/17, 9/30/17, and 12/31/17, would be 4/15/18. The deemed filing date applies to withholding of tax on non-resident aliens and foreign corporations (26 U.S.C. §§ 1441-1464), Social Security tax and Medicare tax (Federal Insurance Contributions Act, 26 U.S.C. §§ 3101-3128), and federal income tax withholding (Collection of Income Tax at Source on Wages, 26 U.S.C. §§ 3401-3406).

The “deemed filing date” rule generally applies if a payroll tax return for any of the quarters of the calendar year is filed on or before April 15 of the succeeding calendar year. When the “deemed filing date” rule applies, the period of limitations will expire 3 years after the deemed filing date. Any return filed after April 15 of the succeeding year has a statute date three years from the date the return is actually filed. See 26 C.F.R. § 301.6501(b)-1(b).

Form 940, *Employer’s Annual Federal Unemployment (FUTA) Tax Return*, is due by January 31 following the end of the calendar year. Form 940 does not have a deemed filing date. Thus, the statute date for the Form 940 is three years from the date the return is filed or due, whichever is later. Because remuneration for service in the employ of a state or local government is generally excepted from FUTA tax under 26 U.S.C.

§ 3306(c)(7), FUTA tax liability does not generally arise in state and local government audits.

There are certain exceptions to the general statute of limitations rules. A taxpayer may voluntarily agree with the IRS to extend the statute of limitations for an open period, which is often done during the course of an audit. For employment tax returns, taxpayers execute Form SS-10, *Consent to Extend the Time to Assess Employment Taxes*, to extend the statutory period for assessment. Under 26 U.S.C. § 6501(c)(3), tax may be assessed at any time if no return was filed by the taxpayer. Additionally, there is no time limit on assessment of tax when a taxpayer has filed a false or fraudulent return with the intent of evading tax. See 26 U.S.C. § 6501(c)(1) and (2).

In summary, the IRS is unable to assess additional employment taxes three years beyond the deemed filing date or actual filing date (whichever is later), except in situations where (1) the taxpayer agrees to extend the applicable limitations period, (2) the required return(s) have not been filed, or (3) clear and convincing evidence exists that the taxpayer has filed a false or fraudulent return with the intent of evading tax.

2. Do the issues with Social Security payroll tax noncompliance also apply when it comes to Medicare payroll taxes?

It depends on the situation, but issues with Social Security payroll tax noncompliance do not always apply when it comes to Medicare payroll taxes. Unlike with Social Security taxes, almost all public employees are subject to Medicare tax, even those in a public retirement system. In 1986, Social Security and Medicare coverage for state and local government employees became subject to different rules. Prior to 1986, the only way for public employees to be covered for Medicare was under Section 218 Agreements. In 1986, Congress mandated that almost all public employees hired after March 31, 1986 must be covered for Medicare and pay Medicare tax regardless of their membership in a public retirement system. A limited exception (the continuing employment exception) is provided to exempt from Medicare only certain state and local government employees who have been in continuous employment with the same public employer since 1986 and who are not covered under a Section 218 Agreement.

For both public and private employers, a decision to exclude a particular payment from an employee's wages based on applicable law would typically result in potential noncompliance with respect to both Social Security and Medicare payroll taxes. For example, if an employer incorrectly determines that a payment to an employee is excludable from wages as a non-taxable fringe benefit, such determination would result in potential noncompliance with respect to both Social Security taxes (unless the Social Security tax wage base had already been reached with respect to wages paid to that individual) and basic Medicare payroll taxes (which are not subject to a wage base limit).

3. In the event that an employer inadvertently withholds too little in payroll taxes, yet reports the same amount on both forms when reporting to both the Social Security Administration (SSA) and the IRS, would the reconciliation process flag this? If not, what other ways can the IRS identify this error?

Generally, the reconciliation process will not flag this situation because that process is looking for discrepancies between the amounts reported to the SSA on Form W-3, *Transmittal of Wage and Tax Statements*, and the amounts reported to IRS on Form 941. In this example, since the amounts are the same, there are no discrepancies to reconcile.

The way to identify the under-withholding is inspection of the underlying payroll records for individuals through the audit process. The IRS uses various data elements in filed returns to evaluate potential for compliance action. For example, the IRS reviews ratios of social security or Medicare wages to total wages.

4. If an employer's quarterly tax return has a zero for taxable Social Security wages, does this automatically generate a flag for follow up? If not, under what circumstances would there be a flag? Are obvious anomalies flagged for review by the IRS, such as everyone in a firm having a salary of \$0 or having the same salary?

For government employers, this situation of zero Social Security wages will not automatically generate a flag absent a discrepancy with the annual Form W-3 and Form W-2, *Wage and Tax Statement*, filings because a government employer and its employees are not necessarily subject to Social Security tax. For example, if a state or local government entity did not have a Section 218 Agreement and did have a FICA replacement plan for all of its employees, then Social Security wages for all of those employees would be zero. However, the employer would still be expected to report Medicare and income taxable wages, and if it did not, the payroll returns of that employer could be selected for audit.

This situation of zero Social Security wages is of the type noted during routine classification of returns for audit. During classification of returns for audit, the IRS would check whether the taxpayer has a Section 218 agreement and review it for the coverage provisions. If the employer appeared not to be in compliance with those provisions, then those tax returns could be selected for audit.

Also during the classification process, large, unusual, or questionable items on Form 941 or W-2, such as the same compensation for every employee, could lead to audit selection.

The IRS would not be able to flag identical compensation by review of a Form 941, which reports compensation only in the aggregate.

5. How do the majority of compliance issues come to light? Do state and local employers self-identify the issue or are they typically found through IRS audits?

IRS receives a large volume of Forms 941-X, *Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund*, which is a method by which employers self-identify and correct compliance issues. Other compliance issues come to light through the audit process, which may result, for example, from a referral made by an employee, an unrelated taxpayer, or a state or local entity claiming there is an area of non-compliance that needs to be reviewed; classification filters; or projects on specific types of employment tax issues. See the response for question 6 below for information on IRS Federal, State & Local (FSL) audit activity rates.

6. What is the percentage of payroll tax noncompliance for all employers? What is this percentage for state and local government employers?

For both public and private employers, FICA and unemployment tax make up about 3 percent of the gross tax gap, according to the most recent IRS study of the tax gap, which covers taxable years 2008 through 2010. The gross tax gap is the sum of the estimated non-filing tax gap, underreporting tax gap, and underpayment tax gap. The data are not compiled at a level of detail distinguishing between public and private employers. For more information on the tax gap, see <https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>.

The IRS audited approximately 0.6 percent of all returns (including income tax, estate and gift tax, employment tax, and excise tax returns) filed in calendar year 2015. IRS Pub. 55-B, *Data Book* (2016) at pg. 21, available at <https://www.irs.gov/pub/irs-soi/16datbk.pdf>. Each year, the FSL function selects for audit a few hundred from tens of thousands of public employers. In FY 2016, of 362 audits of public employers, FSL proposed adjustments to taxable wages in 254.

7. State and local governments regularly make changes to their qualifying retirement plans. How does the IRS make sure that a state/local government's pension plan continues to meet the requirements for being a FICA-replacement plan? How is the assessment made and how often are plans reevaluated? Does this assessment take into account the ultimate benefit amount paid to the pension recipient or just the amount contributed by the employer or employee?

The IRS may examine whether a plan met the requirements for a FICA replacement plan through an audit, by inspecting the plan and evaluating it in terms of the requirements. FICA replacement plan requirements do not affect whether the retirement plan is a "qualified" plan per 26 U.S.C. § 401(a). A retirement system that qualifies as an alternative to Social Security provides for a retirement benefit to the employee that is comparable to the benefit provided by the Old-Age portion of the Old-Age, Survivor and

Disability Insurance program of Social Security. For mandatory coverage purposes, the employee may be a member of any type of retirement plan, including a nonqualified deferred compensation plan such as a section 457 plan, as long as the plan provides the minimum level of benefits required for a FICA replacement plan. These requirements are discussed in 26 C.F.R. § 31.3121(b)(7)-2(e) and in Revenue Procedure 91-40.

The IRS's assessment is based upon the type of retirement plan:

- A defined contribution plan provides an individual account for each participant and provides benefits based solely on the amount contributed.
- A defined benefit plan determines benefits on the basis of a formula, generally based on age, years of service, and salary level.

Publication 963, *Federal-State Reference Guide*, Chapter 6 provides detailed explanations of the FICA replacement plan requirements with regard to the type of retirement system a state or local government may maintain.

Question from Rep. Tom Rice

1. Ms. Lough, you mentioned that 26 U.S.C. § 6103 contains an exception that would allow the IRS to share information with the Social Security Administration. Additionally, you stated that the IRS does share information “when it becomes necessary...with regards to specific public employers.” Under what specific situation does the IRS share information with the SSA? When the IRS does share information with the SSA, what data elements are shared?

26 U.S.C. § 6103(l)(1) allows the IRS, upon written request, to disclose to the SSA tax returns and return information relating to taxes imposed under chapter 2 (self-employment income), chapter 21 (FICA), and chapter 24 (income tax withholding), to administer the Social Security Act; and chapter 22 (Railroad Retirement Tax Act), to administer the Railroad Retirement Act. The IRS may also disclose to the SSA information from Form 8955-SSA, *Annual Registration Statement Identifying Separated Participants with Deferred Vested Benefits*, pertaining to private retirement plans. Additional provisions allow disclosure for other SSA programs, including § 6103(h)(5) (address and citizenship status for purposes of foreign withholding tax), § 6103(l)(5) (information returns and epidemiological research), § 6103(l)(12)(A) (verification of spouse of Medicare beneficiary), § 6103(l)(20) (Medicare Part B premium subsidy adjustment and Part D base beneficiary premium increase), and § 6103(m)(7) (address of person entitled to receive an SSA retirement account statement).

The IRS may ask the SSA about the FICA coverage of particular public employees. A 2002 Memorandum of Understanding between the IRS and the SSA for state and local government compliance issues says that the SSA is responsible for determining the coverage status of state and local government employees covered under a state's Section 218 agreement (including modifications).

In the course of a specific examination, a public employer may direct the IRS to share information with the SSA, the State Social Security Administrator, or any other party. Form 8821, *Tax Information Authorization*, is available for this purpose. On this form,

the public employer may designate the type of tax, tax form, year or period, and specific tax matter for information sharing.

**Chairman Buchanan (FL-16) Questions for the Record
Ways and Means Subcommittee on Oversight
Hearing on the 2017 Tax Filing Season
April 26, 2017**

Questions for Ms. Wielobob, IRS

According to the testimony presented at the hearing, it appears that the W-2 matching has worked to some degree. Some fraudulent returns have been identified and held. However, more than half of the claims filed prior to February 15 were not able to be verified.

1) Has the IRS assessed why the agency was only able to verify about 35-40% of the wage information on the returns prior to February 15? If so, please provide a summary of the findings.

The earlier availability of Form W-2 data enhances the IRS's defenses against identity theft and refund fraud and allows the IRS to determine return consistency with known third party reporting. As of February 16, 2017 (first year the new provision is effective), the Return Review Program (RRP) received data for 220 million Forms W-2, compared to 97 million at that time last year. However, we could only verify wage information for about 35-40 percent of tax returns filed before February 15, 2017 because not all employers are required to file their W-2 forms electronically and the Social Security Administration (SSA) needs time to process and to send information from paper Forms W-2 it processes to the IRS which did not happen until March. In addition, some employers requested extensions to file Form W-2 after February 15.

Nonetheless, receiving earlier Form W-2 data plus having additional time during the refund hold period, provided by the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), allowed us to select additional returns for closer review that otherwise would not have been selected. We identified 162,000 such returns, involving \$862.7 million in refunds, for further review. We continue to evaluate the return data and impact of the PATH Act for this filing season.

2) Would a reduction in the number of employers filing paper W-2 forms help IRS obtain wage data from the Social Security Administration (SSA) faster? If it would not, please propose other solutions that would help expedite the transfer of wage information from SSA to IRS.

SSA has informed us that we would get wage data faster if the number of paper Forms W-2 they receive is reduced. Similarly, we would get nonemployee compensation data faster from an employer or payroll provider if the number of paper Forms 1099 – MISC (with the Nonemployee compensation box checked) was reduced. Currently, under Internal Revenue Code sections 6011(e) and 6724, employers that are required to file 250 or more information returns, including Forms W-2, must file them electronically.

Lowering that threshold would reduce the number of paper Forms W-2 and 1099s to be processed.

3) In addition to the wage information provided by SSA, does the IRS utilize any third-party wage data from non-governmental entities when verifying eligibility for refundable tax credits such as the Earned Income Tax Credit (EITC)? If it does, please describe the source of that data as well as the agency's specific use of it and the number of claims for which the data is used for EITC verification?

We use external third-party information, internal historical taxpayer filing data, business rules, and sophisticated algorithms to identify potentially improper and erroneous EITC claims. There is no single comprehensive government database or third-party data source that we can use to confirm all EITC eligibility requirements. For this reason, we use a variety of sources.

To verify eligibility for EITC, we use information from SSA to confirm Social Security numbers (SSNs), age, parental relationship, and other information. We also use the SSA Death Master File, Prisoner Update Processing System, and Prisoner Address Source database as information sources. To verify the residency of a child claimed for EITC, we use information from the Federal Case Registry maintained by the Office of Child Support Enforcement of the U.S. Department for Health and Human Services.

We use Form W-2 wage information from SSA, which was available earlier in the filing season this year through the PATH Act, and from employers to detect fraudulent and erroneous returns claiming EITC. We also coordinate with SSA to receive a data extract of SSN issuance dates. We used this information to implement another new provision in the PATH Act that denies EITC claims for taxpayers whose SSN is issued after the due date of the return.

The Return Review Program (RRP) also allows us to prevent criminal and civil tax noncompliance related to the EITC using external and internal data, robust tax fraud detection models, and income information. We prevented the payment of more than \$2 billion in suspicious EITC claims in fiscal year 2016 through the fraud and identity theft prevention enforcement programs in RRP. We continued to use RRP this year to address EITC fraud and identity theft.

After RRP identifies potential identity theft and fraudulent returns, the Dependent Database (DDb), an IRS system that uses a set of sophisticated rules and scoring models, along with the internal and external data noted above, identifies further potential EITC non-compliance during processing of tax returns. Last fiscal year we closed almost 380,000 examinations of EITC claims protecting almost \$1.9 billion in revenue, with 75 percent of this being from pre-refund audits.

As part of our post-refund document matching program, we also protected almost \$1.6 billion on EITC returns. In addition, through our EITC return preparer strategy, we

protected \$465 million in EITC and Child Tax Credits by addressing paid preparer errors that our business rules and a scoring algorithm identify.

We continue to look for new sources of data and new tools to stop refundable credit improper payments. However, we need further statutory authority. Currently we lack statutory authority to address, at the time of filing, claims in excess of lifetime limits and the lack of required documents. Instead we must address these errors through audits, which takes longer and requires more resources. Granting the IRS the authority to correct such errors at filing (correctable error authority) would increase our ability to address more of the improper claims and errors we identify and decrease improper payments of refundable credits. The 2018 Budget requested this additional authority.

4) If the IRS does not utilize third party non-governmental wage data, would such data help the IRS reduce improper payments and fraudulent tax refunds from being issued? If the IRS does not believe such data would reduce improper payments, please propose alternative solutions to gathering additional wage information in order to boost verification above the roughly 40% of taxpayer claims currently being verified prior to returns being issued on February 15.

We use external third party information, internal historical taxpayer filing data, business rules, and sophisticated algorithms to identify potentially improper and erroneous refund claims.

As GAO mentioned, the IRS could obtain wage data from the SSA faster if the threshold for mandatory electronic filing of returns was lowered, which would reduce the number of paper Forms W-2 an employer or a payroll provider can submit to the SSA. Similarly, reducing the threshold for mandatory electronic filing of information returns would also reduce the number of paper Forms 1099-MISC that are filed with us, allowing the IRS to more efficiently use data regarding nonemployee compensation on Forms 1099-MISC.

5) Are there any statutory or regulatory obstacles to the IRS using non-governmental third-party wage data to verify taxpayer eligibility for certain refundable tax credits?

We do not have any statutory or regulatory obstacles to using non-governmental third-party wage data to verify a taxpayer's eligibility for income-based tax credits. However, there are no comprehensive government databases or third-party data that we can use to reliably confirm all eligibility requirements for most tax credits, such as the EITC. We continue to look for new sources of relevant data and will seek any necessary authority to obtain access to relevant data, if found. Proposals to provide us with greater flexibility to address correctable errors, and to increase oversight of paid tax return preparers appear in the Administration's 2018 Budget.

**Rep. Walorski (IN-02) Questions for the Record
Ways and Means Subcommittee on Oversight
Hearing on the 2017 Tax Filing Season
April 26, 2017**

Questions for Ms. Wielobob, IRS

6) As you may know, Section 12.101 of the Federal Acquisition Regulation, or FAR, requires federal agencies, including the IRS, to conduct market research to determine whether commercial items are available and to acquire those items when they meet the needs of the agency. What market research was completed vis-à-vis the Return Review Program (RRP) initially as well as in 2013 and 2016 to determine if commercial items could accomplish the RRP mission?

We put RRP into full production after a successful identity theft pilot in 2015, where we tested a new package of commercially available technologies that significantly enhanced detection of identity theft fraud. RRP is replacing the fraud detection components of our legacy Electronic Fraud Detection System (EFDS) in the tax processing system pipeline in filing season 2016. In 2017, it is running as the government's primary line of defense against the perpetration of tax refund identify theft, fraud, and non-compliance, selecting approximately 865,000 potentially fraudulent tax returns claiming approximately \$7.6 billion in refunds (as of May 3, 2017). RRP is far outperforming our legacy EFDS in terms of fraud detection, and since 2015 its return on investment (ROI) is 1,342 percent (based on revenue protected).

We conducted market research in 2009 when we issued a Request for Information (RFI) on December 22, 2009. Twelve vendors responded to the RFI with oral presentations. The outcome revealed that no single product could replace EFDS because this legacy system comprises multiple components supporting a wide variety of separate business functionalities. We ultimately decided to purchase a package of commercially available products and integrate these products to collectively meet RRP requirements for enterprise anomaly detection. The commercial products include: SAS Fraud Framework for Tax for fraud analytics, Fair Isaacs Blaze Advisor (FICO) for Business Rules Engine, and Greenplum for data computing appliances.

A leading industry vendor (IBM) submitted the winning proposal, which included leading industry analytics (SAS Fraud Framework for Tax) and Business Rules engine (FICO). The initial contract was re-competed in 2015. Since the RRP was already operating, we did not do additional market research for commercial products to address the IT solution. However, we conducted market research on the service aspect of the RRP, and specifically, the technical support needed to maintain the RRP system, incorporate legislative mandates, and add any system enhancements. We received three offers, and made the award to the incumbent contractor (IBM) based on a "best value" determination. We rated IBM's proposal as an excellent technical solution that also offered the lowest total overall price.

7) Is the IRS aware of any commercial products currently in use by the IRS or other agencies that could fulfill the existing, unmet requirements of the RRP?

Currently, RRP is running as the government's primary line of defense against the perpetration of tax refund identity theft, fraud and non-compliance, with a ROI of 1,342 percent (based on revenue protected). We are using a package of commercially available products that collectively meet RRP requirements for enterprise anomaly detection. The commercial products include: SAS Fraud Framework for Tax for fraud analytics, Fair Isaacs Blaze Advisor (FICO) for Business Rules Engine, and Greenplum for data computing appliances. As advanced technologies evolve in the fraud analytics and data processing areas, we continue to monitor latest technology products available in the industry that could play a role in delivering future capabilities for the RRP.

8) In 2013, the IRS justified a sole-source contract for the RRP on the grounds that it was the only way to meet the project's aggressive schedule goals. Obviously, those goals have still not been met four years later. Given that failure to deliver, what did the IRS do to hold the awardee and program management staff accountable?

We believe RRP has met its goals as it is fully operational as the government's primary line of defense against the perpetration of tax refund identity theft, fraud, and non-compliance, with additional functionality that has enhanced its performance beyond its original intent. It has replaced our legacy EFDS fraud detection capabilities, performing all identity theft (ID) and pre-refund fraud anomaly detection for filing season 2017, feeding downstream systems with potential fraud selections, and serving as the system of record for ID theft and anomaly detection. In 2017, RRP selected approximately 865,000 potentially fraudulent tax returns claiming approximately \$7.6 billion in refunds (as of May 3, 2017). RRP is far outperforming our legacy EFDS in terms of fraud detection, and since 2015 its current return on investment (ROI) is 1,342 percent (based on revenue protected).

For example, RRP expanded our fraud detection capabilities with the systemic verification of taxpayer wage and withholding data. RRP uses third-party data from employers to match taxpayer wage and withholding information. In 2017, the RRP systemic verification is providing great value to the government by using earlier employer data (provided by the PATH Act) to identify taxpayers with false income and incorrect amounts reported for their wage and withholding.

Also in 2017, RRP is using taxpayer data collected from industry tax software providers. By building stronger and more timely tax fraud detection models, RRP's identity theft detection capability is even more effective and accurate.

The prime contractor for RRP is IBM U.S. Federal, and the subcontractors are Alltech International, Inc.; Deloitte Consulting LLP; Interimage, Inc.; Intervise Consultants, Inc.; JSL; and Tidal. Each contractor agreed to comply with the performance standards described in their contracts and included in the Quality Assurance Surveillance Plan.

The IRS contracting officer's representative (COR) assesses the prime contractor's performance annually. In its performance assessment, the COR rated IBM "very good."

9) The period of performance for the current RRP contract expires this month. The IRS' original cost estimate for the RRP was \$57.5 million, but as I pointed out earlier, cost overruns alone were \$86.5 million as of a couple of years ago. Can you tell me how much the IRS has actually spent developing, testing, and implementing the RRP?

The total cost of RRP as of April 30, 2017, is \$317.7 million, which is higher than the original cost estimate of \$57.5 million in 2010 and later adjusted to \$89.5 million for RRP Transition State 1 (TS1). The reason for the cost increase is that in 2014 we added new, more effective and modern technologies to the RRP to increase its anomaly detection, and in 2015 we expanded the scope of RRP to include the Withholding and Refund (W&R) project to support compliance for our Foreign Account Tax Compliance Act (FATCA) program. These changes added costs that were not a part of the original RRP estimate.

10) How does the Return Review Program compare to the 1994 era EFDS system in terms of success metrics for false positives? Please include data on both identity theft and non-identity theft-based metrics.

In filing season 2017, we retired all EFDS models and RRP successfully took over the analytics processing for identity theft and non-identity theft (formerly scored by EDfS). In addition, we significantly expanded RRP analytics to identify potential fraudulent refund return activity. Therefore, a comparison of the false-positives (or false-detection rates) is not possible between the two systems.

11) During the 2017 Tax Season, how many IRS analysts/users performed analytical work using analytics tools that were delivered as part of the RRP?

In filing season 2017, 1,072 IRS employees performed analytical work using the RRP analytics tools, including 930 employees in Wage & Investment, 120 employees in Criminal Investigations, and 22 employees in Research, Applied Analytics, and Statistics.

**Rep. Bishop (MI-08) Questions for the Record
Ways and Means Subcommittee on Oversight
Hearing on the 2017 Tax Filing Season
April 26, 2017**

Questions for Ms. Wielobob, IRS

12) Ms. Wielobob, 31 U.S.C. 5317 is the statute which authorizes both civil and criminal asset forfeiture. Please indicate the frequency with which the IRS Criminal Investigations (CI) unit utilized its civil and criminal authority, respectively.

Since Fiscal Year (FY) 2007, there have been 343 civil judicial forfeitures and 86 criminal judicial forfeitures under Title 31 U.S.C. 5317 out of a total 72,147 criminal investigations (including primary investigations (PI) and subject criminal investigations (SCI)), as described below.

FY	Administrative Forfeitures	Civil Judicial Forfeitures	Criminal Judicial Forfeitures	Criminal Investigations (PI & SCI)
2007	7	5	4	6,719
2008	12	9	4	6,010
2009	33	25	4	6,814
2010	31	14	8	7,392
2011	30	34	6	7,599
2012	52	61	7	8,183
2013	59	65	16	8,132
2014	70	68	14	6,726
2015	46	49	10	5,974
2016	6	10	11	5,306
2017	3	3	2	3,292
Total	349	343	86	72,147

13) Ms. Wielobob, your testimony indicated that the IRS's procedures related seizure and forfeiture in Title 31 investigations changed in August 2016. Specifically, you indicated that IRS CI agents are now required to provide noncustodial rights, unless acting in support of the Department of Justice (DOJ) grand jury proceedings. In those cases--cases that are under the control of the DOJ—you stated: "They have to give us permission to provide non-custodial rights in the Title 31 cases." Is there a legal requirement that IRS gain permission from DOJ in order to provide non-custodial rights to taxpayers in some Title 31 investigations? If not, then why does the IRS believe permission from DOJ is required in these cases?

Although there is no legal requirement that IRS CI agents get permission from DOJ to provide non-custodial rights to taxpayers in Title 31 grand jury investigations, a grand jury investigation is not controlled by CI. Rather, it is an investigation controlled by the U.S. Attorney's Office or more particularly, the assigned Assistant United States Attorney (AUSA). The AUSA provides instructions for advising taxpayers of their rights. For example, an AUSA may instruct a special agent to advise a target of "advice of rights" when the target is (1) in custody; or (2) when a target is subpoenaed to testify before the grand jury. See *Miranda v. Arizona*, 384 U.S. 436 (1966); U.S. Attorney's Manual, 9-11.151 - Advice of "Rights" of Grand Jury Witnesses.

14) Does the IRS interpret the Taxpayer Bill of Rights (TBOR) codified in Section 7803 as rights that do not apply to Title 31 investigations?

The IRS takes taxpayer rights seriously and we comply with all applicable laws, including those designed to protect the rights of individuals and entities that are the subject of government investigations.

15) Does the IRS interpret the TBOR to apply to any titles outside of Title 26?

The IRS takes taxpayer rights seriously and we comply with all applicable laws, including those designed to protect the rights of individuals and entities that are the subject of government investigations.

16) As a rule, does the IRS apply the TBOR subject to certain exceptions? If so, what exceptions? If not, why does IRS CI believe TBOR does not apply outside of Title 26?

The IRS takes taxpayer rights seriously and we comply with all applicable laws, including those designed to protect the rights of individuals and entities that are the subject of government investigations.

17) Please provide a timeline of the IRS CI consultation with the DOJ in asset forfeiture investigations. Does IRS work with the AUSAs to get warrants? If not, at what time does the IRS first approach the DOJ with the potential for criminal prosecution?

For civil judicial and criminal forfeiture actions, communication with the United States Attorney's Office (USAO) begins during the pre-seizure phase. The AUSAs specifically assigned to forfeiture cases generally consult with IRS CI throughout the entire judicial forfeiture action.

For administrative and judicial seizure warrants, the AUSA will work with IRS CI after the pre-seizure phase to apply for a seizure warrant. The AUSA is responsible for submitting with the court an application of the seizure of the particular property. The application includes the IRS CI Special Agent's affidavit setting forth the facts that provide probable cause for the seizure.

For administrative forfeitures, if a claim is filed on a particular property, then IRS CI must refer the forfeiture to the USAO for judicial forfeiture.

For warrants of arrest in rem, the USAO must review IRS CI's affidavit for the warrant.

18) If a taxpayer is informed that criminal prosecution is a possibility, who is informing the taxpayer of that fact, and when? Are IRS CI agents offering non-prosecution for settlement?

In administrative investigations, IRS CI special agents inform taxpayers that criminal prosecution is a possibility at the initial contact. IRS CI special agents also advise taxpayers of their non-custodial rights during non-custodial interviews involving administrative investigations.

In grand jury investigations, there are a number of means to advise taxpayers of a criminal prosecution, including by a Department of Justice (DOJ) target letter, by a special agent during an initial contact, or by interaction with an AUSA through issuance of a grand jury subpoena to the taxpayer. IRS CI follows the advice of the USAO as to the timing of notification to the taxpayer of potential criminal prosecution.

IRS CI agents are prohibited from offering non-prosecution for settlement because the IRS does not have the authority to engage in plea negotiations. Only the USAO or the DOJ, Tax Division, can conduct plea negotiations.

19) The Free File Program provides an important option for low and moderate income taxpayers to file their taxes. Please provide an update on the performance of the Free File program as well as the IRS efforts to make the public aware of the program. Are there any suggestions on how Congress can improve the Free File Program?

Since the inception of the program in 2003, Free File has provided a means for over 51 million taxpayers to file their federal, and in many cases their state, tax returns free of charge, saving them an estimated \$1.5 billion.

During the past five years, 3,131,994 Free File returns were filed in 2012; 2,971,702 in 2013; 3,260,821 in 2014; 2,961,032 in 2015; 2,592,136 in 2016; and 2,455,422 as of May 12, 2017. Although there has been a slight decline, this may be attributable to Free File companies marketing customers to file directly through the company's web site instead of through IRS.gov.

We use the following channels to notify the public: IRS.gov landing page; news releases; fact sheets; social media, including Twitter and Tumblr; field media interviews with local media; internal messaging to IRS employees; Form W-2 or payroll statements for certain government agencies; and filing season tax tips. Congress can help us

increase public awareness by providing line-item funding for IRS to resume a marketing campaign for Free File.

We continue to improve the program by adding Free File to the IRS2Go app for filing season 2017 and redesigning the Free File web pages on IRS.gov and the company partner web sites for clarity and to offer a better experience for the mobile marketplace.

20) The fight against identity theft refund fraud is incredibly important. The IRS recently stood up an Information Sharing and Analysis Center (ISAC) in order to combat tax fraud and identity theft. In a November 3, 2016, briefing, Commissioner Koskinen said, “participants in the ISAC will provide data in, as well as receive data out, so that it will be a total sharing environment.” What are the obstacles, if any, to IRS being able to be a full participant and share information in the new ISAC? If obstacles are identified, are any of them insurmountable under current law? If any are perceived to be insurmountable under current law, please make suggestions on how Congress may be able to address the obstacles.

We chartered the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (IDTTRF-ISAC) in December 2016 and began pilot operations at the beginning of this filing season on January 23, 2017. The IDTTRF-ISAC is a natural outgrowth of our Security Summit activities which began in 2015 to look holistically at the tax refund identity theft problem across a return’s lifecycle. The purpose of the IDTTRF-ISAC is to share identity theft tax refund fraud data and related analysis with public and private entities in order to detect, prevent, and deter identity theft tax refund fraud. As of late April 2017, the IDTTRF-ISAC has 36 member organizations from state departments of revenue and the tax software and tax preparation industries.

The two primary capabilities being piloted this year are: (1) sharing of tax ecosystem alerts; and (2) analysis of leads generated by the tax software and tax preparation industry as well as other member data. Tax ecosystem alerts are akin to a neighborhood listserv for the tax ecosystem. Members report any tax ecosystem threats they encounter so that others can protect themselves against the threat. Thus far, threats have included employer W-2 breaches, compromised return preparers, new schemes, and dark web chatter about system vulnerabilities. Allowing one member’s detection to be another member’s prevention is a powerful paradigm. Already, the IDTTRF-ISAC has received indicators that members are using alerts to identify suspicious returns in their own systems and stop the further processing of returns seeking fraudulent refunds.

With regard to the second capability, namely the analytical function, members submit data to the IDTTRF-ISAC for the purposes of finding anomalies indicative of potentially fraudulent activity. This capability, of course, depends on the volume and quality of the data the IDTTRF-ISAC receives. In preparation for filing season 2018, the IDTTRF-ISAC plans several data experiments this summer to help identify data with the greatest predictive capacity. We anticipate the IDTTRF-ISAC will realize fuller capability in the

next filing season with its increased number of members and a better understanding of what data is most relevant to identifying and reducing identity theft fraud.

Under the law, we are limited in the ability to share with the IDTTRF-ISAC and certain other external organizations fraudulent or potentially fraudulent data received on a tax return. Section 6103 protects largely all data on a return received by the IRS or gathered by it in connection with the processing of the return, whether the return was filed by the true taxpayer or a fraudulent taxpayer.

IRS is currently exploring all options, to enable better sharing of fraudulent and/or potentially fraudulent tax return information with the tax preparation industry and information sharing and analysis centers such as the IRS' new Identity Theft Tax Refund Fraud ISAC for the purposes of identifying and preventing identity theft tax refund fraud. IRS is also exploring options for it to share fraudulent and/or potentially fraudulent tax return information with other government agencies for the purposes of detecting and preventing cyber threats. IRS would be pleased to discuss where best to target its options in order to implement the necessary changes.

**Rep. Meehan (PA-07) Questions for the Record
Ways and Means Subcommittee on Oversight
Hearing on the 2017 Tax Filing Season
April 26, 2017**

Questions for Ms. Wielobob, IRS

21) How often does the IRS conduct a risk assessment of the FAFSA Data Retrieval Tool (DRT)?

We follow National Institute of Standards and Technology (NIST) 800-63 and OMB guidance on e-authentication risk assessments (eRAs). In accordance with OMB Memorandum M-04-04, *E-Authentication Guidance for Federal Agencies*, we conduct an eRA when an application meets the following criteria: (1) web-based, (2) requires authentication per OMB guidance, and (3) externally facing (or extends beyond border of enterprise). After an initial eRA for these applications, we perform an eRA before system-development to aid in developing the application's architecture and design. We also perform an eRA any time there is intent to change the parameters or data of an online transaction. We review all eRAs annually to ensure their identified assurance level is consistent with our online risk profile and any applicable policies.

The Federal Student Aid – Datashare (FSA-D) Data Retrieval Tool (DRT) meets the OMB Memorandum criteria, and in December 2009, we conducted an initial eRA. In 2015, we started to reassess the level of authentication and associated e-authentication risks for higher risk external customer-facing system. We reassessed the FSA-D at that time and again in 2016.

22) And prior to this incident, when was the last time that the IRS conducted a risk assessment of DRT?

We conducted internal security assessments of the FSA-D, which includes the DRT, in September 2016, resulting in the completion of an updated eRA on October 25, 2016.

23) Did the last risk assessment identify any vulnerabilities?

The eRA indicated the need for stronger authentication.

24) After identifying vulnerabilities with the tool, how long did it take for the IRS to take the tool offline?

We completed the eRA for the FSA-D on October 25, 2016, and we shut down the DRT approximately four months later, on March 3, 2017.

25) According to reports, it took the IRS 5 months to take the tool offline. Why would the IRS wait 5 months—waiting until it is prime time for students filling out the student aid applications – to take the tool offline?

When we discovered the potential DRT vulnerability in September 2016, we took immediate action by increasing monitoring and blocking IP addresses as a short-term solution. We also started working with the Department of Education to implement longer-term solutions, which required changes to both the DRT and to the Department of Education applications. We agreed with the Department of Education that since we did not have any confirmed criminal activity we would monitor the DRT application, rather than shut it down immediately and thereby burden students applying for financial aid. But we advised the Department of Education that if we confirmed the criminal misuse of the DRT application, we might need to shut down the application.

On February 27, 2017, we became concerned about the misuse of the DRT by criminals masquerading as students. After a preliminary investigation confirmed our concerns, we disabled the DRT on March 3, 2017.

26) A March 9, 2017 statement released by the Department of Education reads: “As part of a wider, ongoing effort at the IRS to protect the security of data, the IRS decided to temporarily suspend the Data Retrieval Tool (DRT) as a precautionary step following concerns that information from the tool could potentially be misused by identity thieves.” Is the IRS conducting risk assessments of other outward facing tools?

We review all eRAs annually to determine if the underlying application needs a new or updated eRA. The 2017 eRA review is underway. We assembled a team of experts from our cybersecurity, engineering, and applications development practices to review the eRAs.

**Rep. Holding (NC-02) Questions for the Record
Ways and Means Subcommittee on Oversight
Hearing on the 2017 Tax Filing Season
April 26, 2017**

Questions for Ms. Wielobob, IRS

27) Ms. Wielobob, isn't it true that the number of full time employees in the Criminal Investigation division has decreased by 919 people, a total of 23 percent between fiscal year 2010 and fiscal year 2016?

From Fiscal Year (FY) 2010 to FY 2016, the attrition rate for the Criminal Investigation (CI) division was 22 percent, based on 3,964 full-time permanent employees at the end of FY 2010 and 3,088 in FY 2016. The attrition rate for CI was only slightly higher than the 20 percent attrition rate across the IRS, based on 84,962 full-time permanent employees in FY 2010 and 67,723 in FY 2016. One factor in higher attrition for CI as compared to the rest of the IRS is the mandatory retirement rules for federal law enforcement officers, including CI special agents. Nevertheless, the attrition rate for CI was lower than the rate for other IRS divisions with similar workforce characteristics (higher-graded and longer-tenured) from FY 2010 to FY 2016, such as the Large Business & International division, which had an attrition rate of 27 percent, and the Office of Appeals, which had an attrition rate of 33 percent.

28) The loss of nearly a quarter of CI employees over the span of a handful of years is higher than the overall drop in full time employees experienced throughout the rest of the agency. Are criminal investigations no longer a priority for the IRS?

We take very seriously our obligation to administer the tax law, and we maintain an active enforcement presence to promote equal application of the law to all taxpayers. Criminal tax investigations continue to be a priority.

United States Senate Committee on Finance
The President's Fiscal Year 2019 Budget
Wednesday, February 14, 2018
Questions for the Record for IRS Acting Commissioner David Kautter

Senator Grassley

1. Acting Commissioner Kautter, I have concerns with the slow roll out with the IRS private debt collection program. Several times in 2017, I raised concerns that the number of accounts the IRS planned to release for private collection were woefully inadequate, guaranteeing the program would fall far short of collecting the hundreds of millions in revenue JCT estimates is possible. Unfortunately, this is exactly what has occurred. I understand the need for a testing period to ensure all systems are go, but what concerns me is that we are nearly a year in and the IRS is still placing accounts at little more than a trickle. I am told the program has the capacity to do more than 10 times the volume it is presently operating at.

Why hasn't the IRS implemented the program to the full extent required under the law?

IRS Response: *The IRS takes its obligations under the Private Debt Collection program seriously and is working diligently toward a fully engaged Private Debt Collection program that will endure for years to come. The IRS delivered the first Private Debt Collection accounts to the Private Collection Agencies on April 10, 2017. The initial number of assigned cases was small to ensure the protection of taxpayer rights and the secure transmission of sensitive information. Over the next nine months, we increased the number of assigned cases and by the end of calendar year 2017, the IRS had delivered over 240,000 cases with a total of \$1.7 billion outstanding tax debt to the Private Collection Agencies. In 2018, IRS will assign an additional 700,000 to 800,000 individual taxpayer cases. Business cases will be assigned beginning in 2019. By 2019, we expect to have begun assigning all of the various types of cases to Private Collection Agencies.*

Are there plans to increase the volume of accounts placed with private debt collectors going forward? Please provide information on the planned placement volumes for 2018, including types and a breakdown of dollar sizes of the accounts placed.

IRS Response: *In calendar year 2018, the IRS plans to deliver between 700,000 and 800,000 cases totaling approximately \$5 to \$5.5 billion in total debt. The planned breakdown by dollar (balance due) level is as follows:*

	<i>Dollar Levels</i>		
	<i>\$500-\$10k</i>	<i>\$10k-\$50k</i>	<i>\$50k-\$100k</i>
<i># Cases</i>	<i>512-585k</i>	<i>166-190k</i>	<i>20-24k</i>

In its 2017 annual report to Congress, the Taxpayer Advocate raised concerns that commissions may be being paid to private debt collectors for work done by the IRS. Could you please explain the rules and procedures for determining whether commissions are payable?

IRS Response: *The contract with the Private Collection Agencies outlines the rules and procedures for determining whether commissions are payable.*

The IRS is contractually obligated to pay commissions on any payment received 11 calendar days or more after the date the account is transferred to the Private Collection Agency, and up to 10 calendar days after the date the account is returned to the IRS.

When the Private Collection Agency Contractor collects less than the total amount of the debt referred, the commission fee is calculated based on eligible dollars collected and applied to accounts. When the debt is collected in installments, the commission rate will be paid to the Private Collection Agency Contractor based on the eligible dollars collected and applied to accounts for each installment payment.

Senator Thune

1. Thank you for making sure the revised withholding tables were issued so promptly last month and for doing so in an impartial manner. Employees are starting to see the benefits of the new law in their paychecks this month, and that's a very good thing. When the new tables were released, the IRS announced that the agency is also working on revising the W-4 form, which employees use to set their paycheck withholding. Can you talk about those revisions and specifically whether they will include a way for employees to take into account the \$2,000 child tax credit or the new \$500 non-child tax credit? It would be ideal if parents and those who care for adult dependents could see the benefit of these credits in their paychecks without having to wait until they file their tax return.

IRS Response: *Yes, the 2018 Form W-4, which was released on February 28, does allow employees to take into account the expanded child tax credit, as well as the new non-child tax credit. The IRS also released the updated withholding calculator on the same day. This provides a simple and accurate way for employees to check whether they should adjust their withholding to avoid having too much or too little withheld.*

2. Mr. Kautter, in your prior life, you focused extensively on taxes and small businesses. With the Tax Cuts and Jobs Act only in effect for 45 days, I suspect many small businesses are still factoring the new rules and tax relief into their business plans. Can you share with us how you expect small businesses to react to changes like the expanded expensing for equipment and inventory under the new law and the broader application of cash accounting for small enterprises?

IRS Response: *Treasury and IRS are working to provide guidance on these (and other) provisions as expeditiously as possible so that small businesses and their tax advisors are*

aware of the changes in the new law and can plan accordingly. We also expect small businesses to react positively to expanded expensing and broader application of cash accounting under the new law.

3. One of the biggest issues facing South Dakotans when it comes to their federal taxes is the problem of tax-related identity theft. This not only affects those who have their identity stolen, but also those who find their refund delayed while the IRS verifies their identity. I was pleased to see reports that incidences of tax-related identify theft have fallen, but we need to stay vigilant. Can you talk about the steps the IRS is taking to prevent identity theft and help resolve identify theft cases faster, especially for taxpayers who are entitled to a refund?

IRS Response: *Refund fraud caused by identity theft (IDT) continues to be one of the biggest challenges facing the IRS today. As identity thieves continue to become more sophisticated, the IRS has tightened its security in response to the increased threat. We are making it harder for identity thieves to successfully masquerade as taxpayers and file fraudulent refund claims on behalf of these taxpayers. Over the last several years, the IRS IDT fraud filtering processes has been effective in stopping misuse of information even when data breaches resulted in release of personally identifiable information (PII). Under recently enacted legislation, the due date for filing Forms W-2 and W-3 with the Social Security Administration (SSA) and Forms 1099 reporting nonemployee compensation with the IRS has been accelerated to January 31, beginning in calendar year 2017. Enhancements to IRS systems that allow income information received from SSA to be processed and, in turn, leveraged for systemic income and withholding verification enable the IRS to identify and stop fraudulent returns and release refunds related to compliant returns quicker.*

To help taxpayers resolve IDT cases faster, we centralized our IDT victim assistance policy, oversight, and campus case work in a new Identity Theft Victim Assistance (IDTVA) organization. Benefits to this centralized approach include a common inventory system, reducing hand-offs between multiple IRS functions, improved case processing through streamlined, consistent procedures, and improved communication.

In the victim assistance area, we have reduced the time it takes to resolve a case. For most cases, the average time is now less than 120 days, which is substantially less than 2012, when cases could take over 300 days to resolve. Centralization of IDTVA work significantly reduced case resolution time. Since implementation, we resolve those cases in less than 120 days 75 percent of the time, compared to 34 percent prior to implementation.

We are continuing to develop and implement new procedures to improve the service we provide to IDT victims such as:

- *New IDTVA telephone process allowing a taxpayer to make direct contact with the employee assigned to the case (August 2017).*

- *New procedures to achieve a single point of contact when more than one year is open within IDTVA.*
- *Removed requirement to attach proof of identity documentation, to Form 14039, Identity Theft Affidavit e.g., driver's license, passport, etc., (reducing taxpayer burden).*
- *Utilizing multiple methods to obtain required information to resolve the taxpayer's IDT complaint (often avoiding requesting additional information or documentation).*
- *Automatic case assignment (reducing time to resolve the cases).*
- *Standardized procedures in the Internal Revenue Manual to allow cross-functional casework.*
- *Using Correspondence Imaging System for IDT cases with current or past compliance activity (resulting in quicker case resolution).*
- *Improved the way we track and report the status of IDT cases to quickly identify and make any improvements in the process.*
- *Revised taxpayer letters to provide more information on case status and actions taxpayers can take to facilitate resolution.*
- *Cross-trained IDTVA assistors enabling additional flexibility to assign cases to assistors with the appropriate skills (reducing transfers and expediting case resolution).*

Senator Isakson

1. A provision in the *Tax Cuts and Jobs Act* deals with stock attribution rules as they pertain to inbound companies as well as U.S.-headquartered companies with investments in foreign companies. As the Treasury Department and the IRS issue guidance on the new tax law, I urge its implementation in a manner that is consistent with the provision's historical application and the intent of Congress. Specifically, prior to its repeal in the new tax law, Internal Revenue Code section 958(b)(4) prevented the "downward attribution" of stock ownership from a foreign person to a related U.S. person for purposes of determining the status of a corporation as a controlled foreign corporation (CFC).

The new law's legislative history--the Senate Finance Committee report; a colloquy between Chairman Hatch and my colleague from Georgia, Senator Perdue; and the Conference Report--shows that Congress intended the modification of CFC rules should not result in income inclusions to a U.S. shareholder of a foreign corporation in cases where the U.S. shareholder is neither in control of the foreign corporation nor related to an affiliated group of which the foreign corporation is a part. The treatment outlined throughout the legislative process is also consistent with the purpose and historical application of the CFC rules over their 55-year history.

Given this clear legislative intent and the grant of regulatory authority to implement such intent, will the Treasury Department and the IRS issue administrative guidance to ensure that the modification of the stock attribution rules is implemented in a manner that is both consistent with its historical application and the intent of Congress?

IRS Response: *We are aware of the legislative history of this provision, and we continue to evaluate how best to implement this provision consistent with the statutory text and other indications of legislative intent.*

Senator Roberts

1. The IRS has for many years sought to collect the federal air transportation excise tax, also known as the airline ticket tax, from aircraft management services (AMS) companies that manage and maintain fractional and wholly-owned aircraft programs even though they provide private, non-commercial transportation. The IRS has pursued enforcement action for the ticket tax from AMS companies despite lacking statutory authority to do so. In addition, the agency's collection efforts against AMS companies has been inconsistent and arbitrary, effectively picking winners and losers and resulting in confusion within the AMS industry and an uneven playing field. Along with Senator Portman, I championed a fix for this issue in the recently passed Tax Cuts and Jobs Act (Sec. 13822, H.R. 1) that was included in the final bill and states clearly that AMS companies are not subject to the ticket tax. Our view is that Congress has spoken and that the IRS should respect the law and stop trying to collect the ticket tax from AMS companies. Unfortunately, I understand that the IRS is still pursuing collection of the tax against certain AMS companies for past tax years, undermining the law and creating additional confusion and instability within the AMS industry.

Will you follow the law and the clear intent of Congress by ceasing all on-going and future collection activity of the air transportation ticket tax against aircraft management services companies?

IRS Response: *Guidance was provided to examiners to not pursue this issue on audits in June 2017 and the IRS is no longer pursuing the air transportation excise tax under Internal Revenue Code Section 4261 on fees paid by an aircraft owner to an independent aircraft management company for whole aircraft management services. Audits of this issue were suspended and closed as a no change in 2017. We are also working with aircraft management companies to resolve any claims filed for taxes previously paid on whole aircraft management service fees.*

Senator Whitehouse

1. 26 U.S.C. § 7206(1) makes it a felony punishable by up to three years of imprisonment and \$100,000 in fines for a person who: “[w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter.”
 - a) Why is it important to ensure that taxpayers are providing accurate information?

IRS Response: *It is important for taxpayers to provide accurate information to the IRS because our tax system is based on voluntary compliance. Voluntary compliance is essential in ensuring that all taxpayers pay their fair share. If taxpayers could provide false information, without concern about the consequences, compliance with the tax law would likely suffer.*

- b) Are persons also subject to penalty under the criminal false statement statute, 18 USC §1001, if they knowingly make material false statements to the IRS?

IRS Response: *Section 1001 is generally not used in the case of a false statement on a return because, if the return is signed under the penalties of perjury, as most are, Section 7206(1) of the Internal Revenue Code is considered a more appropriate charge. Because Section 1001 is normally used in criminal tax cases involving a defendant's use of false statements or documents, the elements of the offense focuses on false statements or documents, rather than on concealment.*

- c) What steps does the IRS take to ensure that statements made to the IRS are true?

IRS Response: *IRS ensures the accuracy of tax returns by comparing, among other things, filed tax returns with other information received from outside sources submitted on various IRS forms to include Forms W-2, K-1, 1099, etc. IRS-Criminal Investigations (CI) also verifies the accuracy of returns by obtaining records from taxpayers and contacting third parties such as banks, witnesses, and payroll companies as part of the criminal investigation process.*

- d) Does the IRS review other filings and statements the person has made to the IRS to verify that the information regarding material matters is consistent?

IRS Response: *Yes, see response to (c) above. IRS-CI also reviews other tax years for consistency and patterns, and if applicable, coordinates with the other IRS divisions to obtain any documents or statements that the taxpayer may have provided.*

- e) Does the IRS review other filings the person has made to other federal agencies to verify the information regarding material matters is consistent?

IRS Response: *Depending on the facts and circumstances of the investigation, IRS-CI may review filings or documents submitted by the taxpayer to other federal agencies to either confirm or refute their statements, as permitted by law. For instance, title 12 USC § 3412(f), Use of Information, allows agencies to disclose certain financial records to the Attorney General or the Secretary of the Treasury when there is reason to believe that the records may be relevant to a violation of Federal criminal law.*

2. At the hearing, I asked you to provide information about why the IRS stopped publishing the "The 400 Individual Income Tax Returns Reporting the Largest Adjusted Gross Incomes" data.

- a) Why did the IRS stop publishing this information?
- b) Knowing that this information is useful to the public and to Members of Congress, will you commit to reviving this annual report?

IRS Response: *The IRS eliminated the Top 400 table for two reasons. First, it posed a number of analytical challenges. Since the number of tax returns filed changes from year to year, based on economic conditions and tax law requirements, changes in the data over time are difficult to interpret. For example, in 1992 the top 400 represented .00035 percent of all returns filed, but this declined to .00027 percent by 2014 because the number of returns filed increased over this period by more than 35 million. Thus, increases or decreases in the share of reported income or tax liability attributed to the top 400 cannot be meaningfully connected to actual economic trends. Nor is the 400 a static group. In addition, over an 18-year period, more than 71 percent of individuals included in the top 400 were present for just one year and only 3 percent were present for 10 or more years. This means that the top 400 also cannot be used as a panel to study the changes in income for a fixed group of taxpayers over time. Second, there are disclosure concerns created by producing detailed statistics on such a small group of highly visible taxpayers. The risk that presence or absence of particular data items in the annual table could be exploited by an intruder with access to other information on top earners to generate a credible claim of re-identification has increased over time as the amount of personal information in the public domain increased and the power of computers and analytic capabilities grew.*

*Beginning with Tax Year 2014, the annual October release of Individual Income Tax Return percentile data was expanded to include a new table (**Individual Income Tax Rates and Tax Shares, Table 3**). This table contains all of the item content found in the top 400 data release and groups this information by percentiles of the income distribution. This new table shows data for filers at the .001 percentile level—which in 2014 represented the top 1,396 returns. We believe, this is a more analytically useful tabulation compared to the top 400 tabulation, in that it provides a longitudinally consistent data point relative to the entire percentile distribution. As the number of returns increases with the growth of the economy, the number of returns in the .001 percentile will increase proportionally as well thus allowing for a consistent high-income data series. As a consequence, the top 400 data series was discontinued after Tax Year 2014.*

The IRS Statistics of Income Division (SOI) discussed this change with the professional staff of the Joint Committee on Taxation in October 2014 and this change was endorsed for providing both more useful information to the public and better privacy protection than the Top 400 table. SOI presented the plan and proposed new tabulations at a public meeting, hosted by the Committee on National Statistics at the National Academies, that included more than 90 external stakeholders representing nonprofits, research facilities, and academia, as well as more than 19 federal agencies. Again, there was universal agreement that the new detailed table on tax returns in the top .001 percent of filing population was a much more analytically useful tool than the Top 400 table.

3. According to the IRS, the net tax gap, the difference between what people and companies owe in taxes and what the IRS ultimately collects exceeds \$400 billion per year. This should be the low-hanging fruit of deficit reduction; this is money owed under the law. The budget request notes that an additional \$15 billion for enforcement over 10 years will generate \$44 billion in collections, “yielding a net savings of \$29 billion.” In other words, every dollar spent on enforcement brings in three.

- a) Do you agree that additional enforcement dollars would produce a positive return and help reduce the deficit?

IRS Response: *Yes we agree additional enforcement dollars along with the associated Operations Support dollars would better support the IRS tax enforcement and compliance programs and would produce a positive return and reduce the deficit. The IRS FY 2019 budget includes, as part of the proposed Program Integrity Cap Adjustment, \$362 million in additional investments to expand and improve the effectiveness and efficiency of the IRS’s overall tax enforcement programs in 2019 as well as additional investments in future years. These investments will generate about \$44 billion in additional revenue over 10 years and will cost about \$15 billion for an estimated net savings of \$29 billion. Of these investments, \$290.1 million are in investments for traditional enforcement and strategic revenue programs, and those investments are projected to generate \$2 billion in revenue once the investments reach full potential in FY 2021 an expected total ROI of \$5.2 to \$1. Notably, this return likely is understated because it includes only amounts directly recovered; it does not reflect the effect that enhanced enforcement has on deterring non-compliance.*

- b) Are you aware that the FY19 request for the IRS enforcement budget is nearly \$1 billion lower than Congress appropriated for it in 2011?

IRS Response: *The funding level for the Enforcement account is not the only indicator of the IRS’s tax enforcement efforts. Technology plays an increasingly important role in the IRS’s enforcement strategy and has increased our capacity to identify and prevent non-compliance while also making it easier for taxpayers to comply voluntarily. The proposed investments in the Return Review Program, expanding online payment applications, and hardware and software for enforcement personnel – activities funded from the Operations Support and Business Systems Modernization accounts– also increase enforcement productivity and revenue.*

- c) With the potential for enforcement dollars to cut the deficit, why hasn’t the President requested more?

IRS Response: *The 2019 Budget includes funding to ensure our infrastructure can sustain our programs, including filing season; that taxpayers are provided the services they need to comply with tax laws; that modernization efforts remain on track to provide taxpayers with the tools they need to interact with the IRS; and that enforcement efforts*

continue. The FY 2019 request also includes a Program Integrity Cap adjustment of \$362 million in 2019 (as well as additional cap adjustments for new investments in future years) to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS's overall tax enforcement program.

4. 2 U.S.C. § 441(e) makes it unlawful for a foreign national to “directly or through any other person to make any contribution of money or other thing of value, or to promise expressly or impliedly to make any such contribution, in connection with an election to any political office or in connection with any primary election, convention, or caucus held to select candidates for any political office; or for any person to solicit, accept, or receive any such contribution from a foreign national.”

- a) What role does IRS play in ensuring foreign money does not enter our political system through outside organizations like LLCs and tax exempt organizations?

IRS Response: *This questions appears to refer to 52 U.S.C § 30121 (previously 2 U.S.C. 441(e)), which the Federal Election Commission—not the IRS—is responsible for enforcing.*

With respect to tax exempt organizations and LLCs, the IRS ensures compliance with the Internal Revenue Code and implementing regulations.

We note that a section 501(c)(3) organization is not operated exclusively for one or more exempt purposes if it is an organization that participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. The term candidate for public office means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office is national, state, or local. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate (political campaign intervention or “PCI”) include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such a candidate. Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii).

- b) 501(c)(4) organizations are required to disclose their donors to the IRS. What does IRS do with that information?

IRS Response: *Treasury Regulations require section 501(c)(4) organizations to include Schedule B, Schedule of Contributors, with annual information returns on Forms 990/990-EZ. The IRS maintains this information for use, as needed, in compliance matters.*

- c) Does IRS review the donor lists to ensure that foreign actors are not funneling money into our elections through 501(c)(4) organizations?

IRS Response: As noted above, this questions appears to refer to 52 U.S.C § 30121 (previously 2 U.S.C. 441(e)), which the Federal Election Commission—not the IRS—is responsible for enforcing.

d) Does the IRS coordinate with FinCEN in these efforts?

IRS Response: The IRS has procedures to provide for referrals to the Exempt Organizations Financial Investigation Unit (FIU) if, during the course of an audit, donor information is necessary to determine if an organization is in compliance with section 501(c)(4). Any requests relating to Treasury's Financial Crimes Enforcement Network (FinCEN) are performed by the FIU.

e) Does the IRS coordinate with any other federal agencies to ensure foreign nationals are not prohibited from election activity?

IRS Response: On a case by case basis, IRS coordinates, through its Criminal Investigation Division, with other federal agencies, including FBI.

f) Are the current disclosures to the IRS by such groups sufficient to ensure that foreign actors are not funneling money through cutouts or domestic organizations?

IRS Response: There is no requirement that the nationality of the contributor be shown on the Schedule B, or that an exempt organization request the nationality of its contributors.

g) Does the IRS have sufficient resources to enforce 501(c)(4) rules?

IRS Response: The IRS administers and enforces the tax laws as in effect with the resources available. The TE/GE FY 2018 Work Plan, dated September 28, 2017, sets forth the Exempt Organizations Division's FY 2017 accomplishments and its plan for FY 2018 to continue to be an organization whose key elements are "efficiency, effectiveness, and transparency."

5. Currently the IRS has an 11-factor test to determine if a 501(c)(4) social welfare organization is engaging in political activity

a) Would the IRS and social welfare organizations benefit from more clarity regarding what types of activities constitute under the rules and what amount of money groups are able to spend on "political activity"?

IRS Response: The IRS administers and enforces, and taxpayers are required to comply with, the tax laws as in effect. Section 501(c)(4) provides exemption, in part, for "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare." An organization "is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community." Treas. Reg. §

1.501(c)(4)-1(a)(2)(i). The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office (political campaign intervention, or “PCI”). Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii). Accordingly, although engagement in PCI is not prohibited for these organizations, the primary activities of organizations described in section 501(c)(4) must be the promotion of social welfare.

In addition, section 501(c)(4) organizations that engage in PCI may be subject to tax under section 527(f) on their exempt function expenditures. Whether an organization is engaged in PCI depends upon all the facts and circumstances of each case. The IRS has provided examples illustrating facts and circumstances to be considered in determining whether activities are PCI. See, e.g., Rev. Rul. 2004-6; Rev. Rul. 2007-41. The analysis reflected in these revenue rulings for determining whether an organization has engaged in PCI, or has expended funds for a section 527 exempt function, is factual in nature.

- b) Does the absence of bright-line rules for political spending by 501(c)(4) groups make prosecutions more difficult?

IRS Response: *As stated above, PCI is a factual determination made during the examination process. PCI are generally not subject to criminal prosecutions.*

- c) Do you think there should be a bright-line rule?

IRS Response: *Given the limitations imposed in the recent appropriations acts, the IRS currently cannot issue guidance relating to the standard used to determine whether an organization is operated exclusively for the promotion of social welfare for purposes of section 501(c)(4). The IRS will administer any further statutory direction from Congress on this matter.*

- d) Do the existing 501(c)(4) rules, and the way that they are interpreted within the IRS, hamper your ability to investigate and prosecute cases?

IRS Response: *The IRS administers IRC section 501(c)(4) as currently in effect, processing requests for recognition of exempt status and auditing section 501(c)(4) organizations using existing procedures and applying existing legal guidance. The IRS uses the historical rules that focus on the facts and circumstances in determining whether an organization is engaged in activities that primarily promote social welfare. The IRS provides appropriate training to its employees for this purpose, including mandatory PCI training before each federal election cycle comprised of written materials, virtual e-learning sessions, and face-to-face, small group technical workshops.*

6. Currently no jurisdiction in the United States requires shell companies to disclose their beneficial ownership. Jennifer Fowler, the Deputy Assistant Secretary, Office of Terrorist Financing and Financial Crimes at Treasury recently told the Judiciary Committee that the lack of beneficial ownership information for shell companies is “a vulnerability.” John Cassara, a former Treasury Special Agent and FinCEN Agent,

agreed saying, “[R]equiring the real owner of a U.S. company to be named during the incorporation process will cut down, in dramatic fashion, the ability of criminals to finance their crimes.”

- a) Do you agree that the United States’ lack of beneficial ownership collection presents a serious shortcoming in our anti-money laundering regime?

IRS Response: *The IRS has recently made some progress in the area of transparency of entity ownership. Newly-effective rules that provide an information reporting requirement for foreign-owned LLCs and revisions to the form used to apply for taxpayer identification numbers all will increase availability of beneficial ownership information.*

- b) How can shell companies be used by criminals to avoid paying taxes?

IRS Response: *Shell companies are sometimes a vehicle used in business transactions to avoid disclosing the identity of the beneficial owner of an entity and thus allow the entity to operate anonymously. Shell companies are used in lawful activities and in illegal activities.*

- c) Would having access to beneficial ownership information make it easier for the IRS to investigate tax evasion and other crimes?

IRS Response: *Yes, identifying the beneficial ownership of the assets and the income generated by these activities is essential in determining the correct tax liability and identifying related criminal offenses, both domestically and in assisting our foreign tax treaty partners through exchange of information. Noncompliant taxpayers often spread parts of a transaction among multiple countries and layers of entities to confound determination of ownership and income with respect to the transaction. Robust collection of beneficial ownership information would ease tax examinations by enabling the IRS to look through artificial structures and more clearly determine if the taxpayer was compliant with the tax laws as well as laws related to money laundering.*

Senator Portman

1. Mr. Kautter, my first question relates to a back-and-forth that we have had on the production tax credit for refined coal facilities. Two years ago, the IRS Chief Counsel’s office issued a memorandum that raised issues about the ability to claim the credit depending on the refined coal facilities’ ownership structure. A similar memorandum was issued a year later. The analysis used in these memoranda appear to contradict prior rulings and guidance from the IRS, creating uncertainty for investors as to whether the ownership structures of such refined coal facilities would prohibit them from claiming the tax credit. This uncertainty resulted in many facilities being shut down, bringing with them a substantial loss of jobs and benefits within the industry.

Approximately 10 months ago, six Senators—including Senator Enzi, Senator Cassidy and myself—requested the IRS to issue immediate guidance to the refined coal industry

so that investors could structure their investments to comply with the guidance, thereby preventing further harm to the industry. I understand that the office of Chief Counsel agreed to be responsible for this guidance in order to expedite its issuance. It has now been almost a year and, although the Chief Counsel's office has been telling the industry for the past six months that issuance of the guidance is imminent, to date this guidance has not been issued. This delay is continuing to be harmful to an industry that Congress intended to incentivize.

Can you commit to have the Chief Counsel's office issue this guidance within the next 30 days?

IRS Response: *The IRS issued this guidance on March 9, 2018.*

2. My second question pertains to Notice 2018-13, which was issued by the Treasury Department and the IRS on January 19 to address the rules surrounding the "deemed repatriation" tax. Generally, the new rule requires taxpayers with foreign operations to pay tax on their net CFC earnings, with different applicable tax rates depending on whether those earnings are held in cash or in permanently reinvested assets. I'd like to touch on the "net" part of this calculation.

For the purposes of the rule, businesses are allowed to subtract the losses of CFCs with deficits from the earnings of CFCs with income to calculate an overall number on which tax is owed. Section 3.01 of the Notice provides rules for the treatment of income that has been previously taxed, or PTI. As one would think, PTI is not added to the earnings of earnings CFCs, as it is income that has already been taxed by the U.S. However, the Notice states that companies must net PTI from loss CFCs. This leads to a strange result where, for economic purposes, this income is essentially taxed twice: once under subpart F, and again under the deemed repatriation rules. It also leads to strange results, where similarly situated companies that have similar amounts of overall CFC earnings, losses, and PTI have different tax results because of where their PTI is located.

Can you commit to resolving the above-stated issues of double taxation and location-based disparity in the current rules governing PTI?

IRS Response: *Section 965 provides different definitions that apply for measuring positive earnings and for measuring deficits. The definition for measuring positive earnings specifically excludes earnings that were previously taxed under Subpart F (referred to as "previously taxed income", or "PTI"), while the definition for measuring deficits does not. In Section 3.01 of Notice 2018-13, the Treasury Department and the IRS provided our interpretation of the statute that in determining the amount of a deficit, PTI is taken into account. That is, PTI can reduce the amount of deficits otherwise available to reduce earnings subject to the transition tax.*

The Treasury Department and the IRS requested comments on these provisions described in Notice 2018-13, including the rules described in Section 3.01. The Treasury

Department and the IRS will consider all comments before issuing final regulations under section 965.

Senator Stabenow

1. I often say that we don't have an economy unless we are growing things and making things here. Small businesses are the ones willing to take the risks that grow the economy to create new jobs and innovations.

I am concerned that the tax bill passed last year was not focused on helping small businesses and instead added new complications for them on their taxes. For instance, there is now a 20 percent pass-through deduction, but a small business is not allowed to take the deduction if the "principal asset of the trade or business is the reputation or skill of one or more of its employees or owners." If I owned a small business, I would be pretty confused as to whether I qualify for that deduction. One of the reasons most people decide to open a small business is because of their reputation and/or skill.

Is the IRS prioritizing releasing guidelines for small businesses, to help them figure out if they can take the pass-through deduction?

What is the IRS's plan to get that information out to small business owners?

IRS Response: *Guidance in this area is one of our top priorities. This is reflected in the Second Quarter Update to the 2017-2018 Department of the Treasury Priority Guidance Plan published on February 7, 2018, that includes section 199A guidance. This guidance will address the issue of when the principal asset of a trade or business is the reputation or skill of its employees or owners. We are also working with Treasury on various communications, including revisions to Forms, Instructions, and Publications to assist taxpayers, including small businesses, in determining whether they are eligible to claim this deduction for small businesses.*

2. What I am hearing out of the IRS currently is not reassuring me that the changes to the tax code are going to make it easier for families to understand their taxes.

The IRS has given employers new withholding tables, but has also said that families need to go to the IRS's website to make sure the amount of taxes being taken out of their paychecks is correct. Under the previous tax law, more than four times as many Michigan families received a tax rebate compared to those who owed additional taxes.

- a) If an individual or family does not have sufficient taxes withheld, what are the consequences?

IRS Response: *In January, we released new withholding guidance under the Tax Cuts and Jobs Act. The withholding guidance was designed to work within the constraints of the existing payroll withholding system in order to minimize the burden on taxpayers and employers. We have encouraged taxpayers to use our withholding calculator to ensure*

they have the correct amount of withholding. The results of the calculator can be used to determine if they should file a new Form W-4 with their employer.

If individuals or families do not have sufficient taxes withheld, they will owe the additional tax at the time they file their tax return. Payment of the tax with a return filed by the due date will not result in interest being due. However, an underpayment tax penalty might be owed unless the taxpayer qualifies for an exception.

If taxpayers discover their withholding will not be sufficient to pay their tax obligation during the tax year, they may increase their withholding or make estimated tax payments throughout the year. Estimated taxes are generally calculated using the Form 1040-ES, which may be found on IRS.gov, along with in-depth information on estimated taxes.

If the taxpayer cannot pay the tax with the return, we encourage taxpayers to request an installment agreement by using our on-line payment application on irs.gov. Interest and failure to pay penalty will apply to late.

- b) What data can the IRS provide about how many taxpayers will be receiving a smaller refund check for their 2018 taxes compared to the one they received for their 2017 taxes, based on the withholding changes?

IRS Response: *The Treasury Department's Office of Tax Analysis research suggests that if people do nothing, about the same number will receive refunds for 2018 as would have under prior law. However, because individual circumstances will vary and because many taxpayers receive large refunds (and some owe tax) when they file for any given year, the IRS is encouraging all workers to do a "paycheck checkup" to ensure that they are not having more or less tax withheld than they intend. The withholding calculator found at IRS.gov is designed to assist taxpayers in making sure they have the proper amount of tax withheld from their paychecks.*

- 3. Two years ago, the IRS Office of the Chief Counsel issued a memorandum calling into question the eligibility of investors participating in some types of ownership structures for production tax credits for refined coal facilities.

Both the Department of the Treasury and the IRS stated their commitment to quickly issuing guidance to provide certainty to the industry and avoid further shutting down of facilities and losses of jobs. Thus far, the promised guidance has not been forthcoming, even in light of assurances that its issuance was imminent.

Congress created the refined coal production tax credit to encourage the production of coal that is less polluting. However, the uncertainty surrounding the eligibility of this tax credit has led to less investment and shuttering of facilities – the opposite of the legislative intent of this provision.

Can you commit to a firm timeline for releasing guidance on the refined coal production tax credit to provide certainty to the industry moving forward?

IRS Response: *The IRS issued this guidance on March 9, 2018.*

4. Michigan families are extremely charitable. Eighty-five percent of Michigan families make charitable donations to help their community and those in need. Charitable giving helps feed families that do not have enough to eat, delivers education and support to children, and provides housing to those who are not fortunate enough to have a roof over their head.

However, the tax bill passed last year has caused great concern among charitable organizations. There are countless estimates that the recent tax legislation could reduce charitable giving by billions of dollars every year. As charitable organizations scramble to try to make up the difference, corporations are projecting record profits.

- a) What data will the IRS and/or Treasury be collecting about how this new tax law is impacting charitable giving?

IRS Response: *The IRS will continue to collect and publish detailed data from Form 1040, Schedule A filers, including lines 16-19. This data will continue to be reported in detailed tables further disaggregated by filing status, AGI class, etc. IRS will also continue to produce regular statistics on the types of non-cash contributions claimed on Schedule A. In addition, during the 2019 filing season, the IRS will augment current filing season reports (released in late May, mid-July and mid-November on irs.gov) to provide high-level, early statistics on the impact of tax law changes on filing behavior, including for example changes in the number of taxpayers electing the standard deduction. However, it is important to remember that we can only observe charitable contributions claimed as a deduction using data from Form 1040 Schedule A; we will not have any information on charitable gifts made by individuals who claim the standard deduction.*

The IRS will also continue producing statistics on the income and balance sheets of charities (that file Forms 990 and 990-EZ) and private foundations (that file Form 990PF). About 24 percent of all active, IRS-recognized charities file these information returns, and for them, we will be able to track changes in reported contributions over time. The remaining 76 percent, which include churches, religious organizations and organizations with annual gross receipts less than \$50,000 are not subject to detailed filing requirements. It is also important to note that donations received by charities during calendar 2018 will be reported on information returns filed in 2019 or 2020, depending on the accounting period adopted by each charity. This means that complete data on the potential impact of tax reform on charitable giving to organizations that have a Form 990 filing requirement will not be available for several years.

- b) What percentage of people do you estimate will take the charitable deduction after the changes to the tax law passed at the end of last year?

IRS Response: *The IRS does not have a projection of the percentage of individual income taxpayers who will claim a charitable deduction for tax years 2018 and beyond.*

Senator Cassidy

1. Identity theft. While your testimony noted that IRS has reduced the number of fraudulent returns, has the amount of improper payments related to those fraudulent returns also decreased? If so, by how much?

IRS Response: *The number of tax returns with confirmed identity theft declined to 597,000 in 2017, compared to 883,000 in 2016 – a 32 percent decline. The amount of refunds protected from those fraudulent returns was \$6 billion in 2017, compared to \$6.4 billion in 2016. In 2015, there were 1.4 million confirmed identity theft returns totaling \$8.7 billion in refunds protected. Overall during the 2015-2017 period, the number of confirmed identity theft tax returns fell by 57 percent with more than \$20 billion in taxpayer refunds being protected.*

2. Identity theft. How much did Treasury disburse in improper payments related to fraudulent returns for the most recent year available?

IRS Response: *The IRS monitors the extent of identity theft refund fraud through our Taxonomy. This research-based effort aims to report on the effectiveness of IRS's identity theft defenses to internal and external stakeholders, help us identify identity theft trends and evolving risks, and refine identity theft filters to better detect potentially fraudulent returns, while reducing the likelihood of flagging legitimate tax returns.*

For 2016, refunds attributable to identity theft that were paid are estimated to be between \$1.68 to \$2.31 billion whereas identity theft refunds protected are estimated to be between \$10.56 to \$10.61 billion. Both estimates are lower than they were in 2015 (\$2.24 to \$3.34 billion unprotected refunds and \$12.35 to \$12.88 billion protected refunds).

3. Trade-based money laundering. What factors does IRS consider in determining whether to pursue a transfer pricing audit? Is potential involvement in a trade-based money laundering scheme considered?

IRS Response: *Transfer pricing audits determine whether transactions between related parties comply with Internal Revenue Code 482 and meet the arms-length standard of the Section 482 regulations. Factors considered in determining whether to pursue a transfer pricing audit include the volume and type of intercompany transactions, and the risk for income shifting. Transfer pricing cases require a thorough analysis of functions, assets, and risks, and an accurate understanding of the related financial information. Because trade-based money laundering involves a process of disguising criminal proceeds through trade to legitimize their illicit origins, it is not the focus of transfer pricing audits. The IRS has, however, studied the use of trade data in the past to identify transfer pricing issues based on anomalies in such data.*

4. Trade-based money laundering. What percentage of cross-border transactions are subject to a transfer pricing audit?

IRS Response: *As of February 28, 2018, approximately 1,600 out of 8,000 open examination cases in the Large Business and International (LB&I) division involve transfer pricing issues. For Tax Year 2015 (returns filed in calendar years 2016 and 2017), the most recent year for which complete statistics are available, there were more than 6 million Form 1120 series returns filed. Based on the attachment of certain international forms, an estimated 1.9 percent of them have the potential for transactions subject to transfer pricing. It is not possible to precisely estimate how many of these returns have cross-border transactions because these transactions can include a wide range of activities, including sales of tangible and intangible property, certain interest payments, managerial or service fees, commissions, rents, royalties, and other types of payments, not all of which can be identified from tax data without an audit.*

5. Trade-based money laundering. Please describe the extent to which IRS exchanges transfer pricing or other data with FinCEN, CBP, DHS, DOJ, and other federal agencies to assist with their anti-trade-based-money-laundering activities.

IRS Response: *IRS generally does not exchange transfer pricing or other trade-based money laundering (TBML) data due to the restrictions imposed by 26 USC § 6103; however, the IRS-Criminal Investigation (IRS-CI) special agents that are detailed to law enforcement & intelligence community partner agencies do at times encounter TBML-related data and may share this data with other sections within IRS-CI.*

In addition, IRS-CI participates with other federal law enforcement agencies in significant, impactful money laundering investigations which often have a TBML component.

Senator McCaskill

1. The recent changes to our tax laws may create new avenues for tax fraud. Does the IRS have the tools needed to identify new and emerging threats?

IRS Response: *IRS uses several tools to assist in combatting tax-related identity theft and fraud. This includes tools that are specific to addressing taxpayers who have been victims of a data loss of federal tax information (FTI). Because the data losses involving federal tax related data can be used to file returns that appear to be coming from the true taxpayer, IRS has implemented measures to address this. IRS's existing models and filters have been updated to address the level of sophistication used to file these fraudulent returns. We have implemented the use of Dynamic Selection Lists that allow IRS to monitor accounts of specific taxpayers who have been victims of an FTI data breach when the data compromised would have a direct impact on federal tax administration. This allows the IRS to more effectively identify these suspicious returns and results in better protection for taxpayers' federal tax accounts and increased revenue protection. In*

addition, there are multiple points in the processing life cycle to identify, prevent and assist possible IDT victims: pre-filing, at-filing, post-filing.

To prevent IDT returns from even coming in the door (pre-filing), we have worked with tax software providers to improve the procedures that new and returning customers must use to identify themselves in order to minimize the chance that the taxpayer's online account can be taken over by identity thieves. This additional security is one of the most visible signs of increased protection to taxpayers because they will notice password requirements and other website security features. In addition, we have implemented a variety of mechanisms to prevent criminals from using a deceased individual's identity information to perpetrate fraud. We routinely lock the accounts of deceased taxpayers and have locked more than 30 million accounts so far.

At-filing, our IDT and fraud detection systems contain complex models and filters developed from historical and newly emerging known fraud characteristics. Address and bank account changes as well as historical taxpayer filing data are characteristics that are used in conjunction with other filters to identify potentially fraudulent/IDT returns. When returns are selected by a filter, the refunds are frozen until additional reviews verify whether the refunds are legitimate.

2. In 2009, the IRS changed longstanding rules for the St. Louis Carpenters Pension Plan, preventing members from receiving pension payments while remaining in covered employment. The Vested Employee Pension Benefit Protection Act (S. 1080) would allow for the IRS to reinstate this practice for some workers. Will you commit to reviewing and reconsidering this earlier IRS ruling?

IRS Response: *Code section 6103 generally precludes us from commenting on questions relating to particular taxpayers. However, please let us know if we can provide any other information that is not subject to section 6103.*

3. If you recall, the Internal Revenue Service (IRS) found out about the Equifax breach in the news, as the rest of America did. Equifax claimed it didn't need to notify IRS about the breach because IRS data wasn't compromised. Does the IRS now require that contractors notify the IRS if they suffer breaches exposing data, regardless of whether IRS data is specifically breached? Are there other requirements in place for what a contractor must do if they experience a cyberattack?

IRS Response: *No, the IRS only requires contractors to notify the IRS if they suffer breaches exposing IRS data. However, the IRS extensively updated requirements (i.e., Publication 4812) to strengthen contractor security controls and reduce the agency's exposure to risk as a direct result of the Equifax data breach.*

The IRS inserts clause IR1052.224-9008 – Safeguards Against Unauthorized Disclosure of Sensitive But Unclassified (SBU) Information (Nov 2015) – in all solicitations and resulting contracts, agreements and orders, if the contractor (or subcontractor) will have access to SBU information. This clause requires contractors who perform work at

contractor (including subcontractor) managed sites using contractor or subcontractor managed IT resources to adhere to the guidance, requirements, and specific security control standards contained in **Publication 4812**, Contractor Security Controls; **IRM 10.23.2** - Personnel Security, Contractor Investigations; and **IRM 10.8.1** - Information Technology (IT) Security, Policy and Guidance.

Below is some relevant language that describes specific reporting requirements in these documents:

Excerpt from **Clause IR1052.224-9008** – Safeguards Against Unauthorized Disclosure of Sensitive But Unclassified Information (Nov 2015):

- Publication 4812, IRM 10.8.1 and 10.23.2 provide comprehensive lists of all security controls and guidance
- In addition, if the SBU information is or involves returns or return information, or threatens the safety or security of personnel or information systems, the contractor shall report the incident/situation to the Treasury Inspector General for Tax Administration (TIGTA) hotline.
- The contractor (including subcontractor) shall report any incident/situation in accordance with IRM 10.8.1.4.8.5 - Incident Reporting - to the COR. This includes a variety of different levels of incidents such as the installation of malicious code, unauthorized access to a system, or denial of service attacks, when IRS data is breached.

Excerpt from **Publication 4812** – Contractor Security and Privacy Controls; **Section 18** – Incident Response:

- A data breach is the loss of control, compromise, unauthorized disclosure, unauthorized acquisition, or any similar occurrence where (1) a person other than an authorized user accesses or potentially accesses personally identifiable information or (2) an authorized user accesses or potentially accesses personally identifiable information for an other than authorized purpose.

Whenever there is a compromise of IRS information, it is important to contact the IRS within one (1) hour if an incident or potential incident has been detected. The IRS shall work closely with IRS contractors to quickly respond to a suspected incident of unauthorized disclosure or inspection.

Excerpt from **IRM 10.8.1** - Information Technology (IT) Security, Policy and Guidance; **Section 10.8.1.4.8.5** (7-8-2015) - Incident Reporting.

- All IRS employees and contractors shall be responsible for reducing the impact and severity of security-related incidents by immediately reporting suspicious or anomalous (e.g., uncharacteristic, atypical, inconsistent) events, all losses and thefts of assets, and any disclosures of personally identifiable information (PII) in accordance with policy and procedures specified in the IRS CSIRC organization's Computer Security Incident Reporting Procedures. (IRS-defined)

In keeping with OMB directives, any incident that involves compromised PII must be reported to US-CERT (via the Treasury Computer Security Incident Response Center (TCSIRC)) within 1 hour regardless of the incident category reporting timeframe. (TD P 85-01 App G)

4. Using site visits, IRS found that Equifax was mishandling and improperly storing IRS data, although IRS determined that none of the data was exposed. How did the discovery that IRS was mishandling data change the way IRS conducts oversight of contracts or how the IRS develops requirements for future contracts? What changes has the IRS made to its contracting practices?

(a) How did the discovery that IRS was mishandling data change the way IRS conducts oversight of contracts.

IRS Response: *NOTE – The IRS was not mishandling data. Equifax was improperly storing IRS data in transaction log files in violation of contractual requirements.*

The IRS continues to use Publication 4812, Contractor Security Controls, as the framework and guiding principles and processes for conducting security assessment to monitor compliance and assess the effectiveness of a contractors' security controls. The Offices of Information Technology (IT) and Procurement collaboratively identify and prioritize which contracts align with critical applications supporting filing season. If new information technology is being developed in support of an IRS program, a review is conducted before data is shared and then included in the annual prioritization process. IRS IT will conduct on-site Contractor Security Assessments (in accordance with Publication 4812) to assess and validate the effectiveness of security controls established to protect IRS information and information systems. These assessments help to determine if, and when, additional controls or protections are necessary to protect returns and return information or personal privacy, or other SBU information, and organizational assets and operations.

(b) How did the discovery that Equifax was mishandling data change how the IRS develops requirements for future contracts?

IRS Response: *The IRS is undertaking various initiatives to improve requirements definition and the procurement process, as well as strengthen contract administration by the Contracting Officers Representative. For example, we have instituted an innovative method for bringing the entire acquisition team together early in the procurement process to discuss and define requirements, adjudicate issues/concerns, leverage "wisdom of crowds," and document complete and accurate acquisition packages and milestone timelines. The acquisition team consists of the contracting officer, requirements owner (business unit and/or IT), legal counsel, policy/quality assurance specialist, and cost and price analyst. Other subject matter experts (such as other Bureaus if Treasury-wide) participate, depending on the requirement, risk, complexity, magnitude, and scope. This is called a Procurement Innovation Team. Additionally, the IRS Cybersecurity team identifies a single point of contact to assist Procurement in*

understanding any unique or complex security issues. This has improved collaboration and knowledge sharing across all organizations. Furthermore, the Office of Procurement Policy is leading a review of all IRS-specific clauses to verify accuracy, confirm language and requirements are up-to-date, and ensure prescription(s) for use are precise.

(c) What changes has the IRS made to its contracting practices?

IRS Response: *The IRS has taken a number of steps to improve its contracting practices, including the development of a new Procurement Strategic Framework. It includes 31 key initiatives to promote proactive, data-driven actions that increase transparency and accountability, improve productivity, and cultivate an agile workforce with the skills to adapt to an evolving acquisition environment. Below are a few examples of actions underway:*

Acquisition Planning

Acquisition planning is the process by which the efforts of all personnel responsible for an acquisition are coordinated and integrated through a comprehensive plan for fulfilling the agency need in a timely manner and at a reasonable cost. We are proactively engaging requirements owners earlier in the acquisition process to strengthen our ability to identify and develop customer requirements, as well as to improve long-term acquisition planning. This includes a specific focus on identifying requirements vulnerable to a cybersecurity attack to assure all required clauses are included in the solicitation and resulting contract.

Risk Identification and Mitigation

The framework includes the identification of potential risk areas for key acquisitions and the development of strategies to better mitigate these risks. We are collaborating with Treasury's Office of the Procurement Executive to develop risk-based criteria for reviews/approvals instead of using total dollar value as the main determining factor for senior level oversight. Additionally, the Chief Procurement Officer (CPO) initiated a simple method (i.e., CPO Critical Information Requirements) for contracting staff, at any level, to elevate a potential risk or issue immediately through the chain of command.

Use of Government-wide Contracts

We have developed an implementation plan to migrate actions from IRS stand-alone vehicles to government-wide and Best-In-Class contracts. This approach leverages best industry practices and allows the IRS to benefit from economies of scale. The plan is continually reviewed and new actions are added as requirements are received.

Business Process Improvements

We are streamlining and simplifying processes to improve efficiency and flexibility of procurement operations. This includes taking steps to reduce higher-risk procurement methods, including the use of bridge contracts. We drastically reduced our procurement policies and procedures by deleting over 800 pages of redundant, outdated or overly

complex requirements. Additionally, we are automating the pre-solicitation review processes to decrease administrative burden and lessen procurement action lead time.

5. The Federal Information Technology Acquisition Reform Act (FITARA) requires agencies, and specifically Chief Information Officers of agencies, to conduct risk assessments when procuring information technology goods or services. What type of risk assessments did the IRS conduct when reviewing the bid proposals for the contract currently held by Experian?

IRS Response: *The contract with Experian was awarded against GSA schedule 520, Financial Business Solutions, as a professional services contract and therefore not subject to FITARA.*

Prior to making an award to Experian on July 5, 2017, IRS validated Experian met basic connectivity and transaction interface requirements. After award, we planned to perform a comprehensive on-site security review with Experian prior to sharing data; however, it was put on hold because the protest filed by Equifax on July 7, 2017 triggered an automatic stay of performance with Experian. Immediately following GAO's decision to deny the protest on October 16, 2017, IRS conducted the review as previously planned with Experian. The results identified 16 findings, including one high risk finding. Experian was given 30 days to remediate the findings. The IRS conducted a follow-up review on November 30, 2017 and validated that Experian had corrected 9 findings including the high-risk finding prior to going live. An additional on-site review was performed on March 2, 2018. There are 3 outstanding moderate findings remaining, and the low finding is no longer applicable to the environment.

6. When IRS issued the bridge contract to Equifax, it clearly did not have all of the information it needed to understand the full extent of the security issues. It also seemed that IRS did not build in enough time to account for a possible bid protest. What steps has IRS taken to improve the acquisition planning process to ensure that bridge contracts are truly an option of last resort?

IRS Response: *We are developing a new Procurement Strategic Framework with key initiatives that focus on strengthening the IRS's ability to identify and develop customer requirements. An emphasis is on earlier customer engagement in the planning process between Procurement and the customer to ensure acquisition strategies are executable, mandatory contract vehicles are identified, and milestones are defined and agreed to in order to eliminate the need for short-term contract actions. Additionally, we are providing concentrated training in areas that will directly reduce the chance of a protest, such as how to perform best value tradeoffs and how to perform a debriefing after award. Lastly, we are increasing transparency and outreach to industry partners by posting information on FedBizOps, issuing requests for information and draft solicitations, and holding requirement-specific industry days.*

7. The Senate Homeland Security and Governmental Affairs Committee recently approved my bill, S. 2413, to bring greater accountability and transparency to bridge contracts.

Notably, the bill requires amending the Federal Acquisition Regulations to develop a common definition of bridge contracts, increases reporting requirements for agencies on their use of bridge contracts, holds senior officials accountable for approving of long-term bridge contracts, and requires public notice when an agency enters into a bridge contract. I believe that this will help to avoid the situation the IRS faced with Equifax. Can you provide a current list of all bridge contracts that the IRS has entered into in the past year, broken down by category of contract, and the amounts and duration of those bridge contracts? What assurances can you provide the Committee that the IRS has strengthened its acquisitions and contracting program to avoid a similar instance to the Equifax data breach and bridge contract incident?

IRS Response: *Neither the IRS contract writing system nor the Federal Procurement Data System (FPDS) currently has the capability to distinguish a bridge contract from other types of contracts.*

The IRS takes risk management and security issues very seriously and is committed to fulfilling its mission while safeguarding the public's trust. We have taken the opportunity to learn from the Equifax situation and implemented several process improvements and safeguards across the agency. Below are a few examples of actions underway:

Procurement Strategic Framework

The Office of Procurement is crafting a deliberate strategic framework that includes 31 tactical initiatives to enhance internal operations and promote proactive, data-driven actions that increase transparency and accountability, improve productivity, and cultivate an agile workforce with the skills to adapt to an evolving acquisition environment.

Earlier Engagement

The Office of Procurement is proactively engaging requirements owners earlier in the acquisition process to strengthen the IRS's ability to identify and develop detailed requirements, as well as improve long-term acquisition planning. This includes a new initiative that Procurement has instituted for bringing the entire acquisition team together earlier in the acquisition process to discuss requirements, adjudicate issues/concerns, leverage "wisdom of crowds," and document complete and accurate acquisition packages and milestone timelines. This method is called a Procurement Innovation Team (PIT).

Elevation of Issues Quickly

Ensuring information is elevated to the highest levels of the organization quickly has been instituted within the Office of Procurement. The Chief Procurement Officer (CPO) established a process (i.e., CPO Critical Information Requirements) whereby an employee, at any level, can elevate information, unimpeded, through the chain of command as soon as an issue/concern is recognized. This will allow an opportunity for executive involvement and influence prior to actions being executed.

Incident Response Team

The value of immediately standing up a multi-disciplinary team with all stakeholders has proved beneficial in sharing information timely and synchronizing various actions. While we recognize this is employed after an incident has occurred, it is a critical component of our risk mitigation strategy.

Senator Menendez

1. Mr. Commissioner, in October, 32 Members of the House Ways and Means Committee – both Republicans and Democrats – sent a letter to the Treasury Department asking it withdraw IRS Notice 2007-55 which was issued over a decade ago and continues to deter foreign investment in the United States. The notice relates to the Foreign Investment in Real Property Tax Act, or FIRPTA. In short, the notice treats certain distributions from REITs as the sale of REIT assets rather than the sale of REIT stock. The result is that the distributions are subject to tax rates as high as 54 percent. The practical effect is to raise the tax burden on investors in U.S. commercial real estate and infrastructure to levels that are punitive and prohibitive. Cal-Berkeley professor and economist Ken Rosen recently estimated that FIRPTA costs the United States between \$65-125 billion in lost investment and between 147,000-284,000 in lost jobs. This is an infrastructure issue—FIRPTA blocks private investment in U.S. infrastructure. Repealing IRS Notice 2007-55 is a simple and immediate thing that the Administration could do to boost private investment in U.S. real estate and infrastructure.

Many of us have been working on this issue for years—no senior official seems willing to defend the current notice, but it just keeps getting kicked down the road.

Could you review this matter and let us know within 30 days, in writing, whether you will repeal section two of the Notice and restore prior law, as dozens of Members of Congress have encouraged?

IRS Response: *Thank you for your inquiry. IRS is aware that this long-standing issue is a priority for many members of Congress. We look forward to continuing dialogue with the Treasury Department, Members of Congress, and other stakeholders as we work on this issue.*

United States Senate Committee on Finance
Senate Finance Committee Hearing on “The 2018 Tax Filing Season and Future IRS Challenges.”
April 12, 2018
Questions for the Record for IRS Acting Commissioner David Kautter

Chairman Hatch

1. Perhaps one of the most difficult challenges the IRS faces is with information technology. Directly related to that challenge is the question of human capital. For instance, the IRS’s Individual Master File is its legacy tax processing system and is in many ways the backbone of the IRS’s information technology infrastructure. But that system, which is based on antiquated software, has only 17 developers whom the IRS considers to be subject matter experts. We have heard concerns that some of those employees will retire soon, and many of those remaining will be eligible for retirement within four years. Young IT experts aren’t necessarily eager to join the IRS to learn how to run antiquated systems.

Almost 60 percent of the IRS’s workforce is over the age of 50, and there are not enough younger workers coming in to replace those who retire.

What can IRS do to attract younger skilled workers, and what can Congress do to help?

IRS Response: The IRS recognizes that the current age distribution of its workforce poses a long-term risk to the organization, particularly in highly-skilled, technical programs. As of May 2018, 32.2% of the IRS’s current permanent workforce will be eligible to retire by the end of fiscal year (FY) 2020. As you note, IRS’s human capital challenges include a limited number of subject matter experts in key information technology (IT) areas. Similar challenges exist in other technical and specialized fields.

The IRS has taken several steps in recent years to mitigate this risk. It has expanded partnerships with colleges and universities and participated in job fairs to recruit new talent, with a focus on military veterans and IT disciplines such as cybersecurity. The IRS is establishing a centralized recruitment office to better coordinate and oversee these efforts. The IRS has also leveraged flexibilities under the federal Pathways internship program and recent graduate hiring authorities to attract and retain new talent. In FY 2017, the IRS hired 307 Pathways interns and recent graduates. This includes 121 IT positions. Additionally, the IRS has increased use of the Student Volunteer Program and other unpaid third-party internships to help students explore IRS career opportunities.

Congress can assist the IRS by reinstating the IRS’s Streamlined Critical Pay Authority (SCP), which provided the IRS some flexibility to recruit and retain highly-skilled employees with specialized expertise, particularly in high-demand areas of information technology. Established under the Restructuring and Reform Act of 1998, SCP allowed the IRS to hire up to 40 uniquely qualified experts for four-year appointments to

revitalize and enhance its workforce. The SCP authority allowed the IRS to hire top-caliber talent under an abbreviated timeline and at a salary more competitive with private industry. The IRS SCP authority expired in 2013, and the Administration's FY 2019 Budget requests that Congress reinstate this authority through FY 2022. Reinstating the SCP authority would allow IRS to recruit and hire other highly-specialized talent for critical positions to modernize, innovate, protect taxpayer data, and accomplish the IRS mission.

2. Access to telephone customer service has improved since it reached a low point in 2015. IRS has also redesigned its website, added online access to account information, and offered appointments to its walk-in locations serving taxpayers in person.

- a. What has IRS done to achieve these improved customer service results?

IRS Response:

Each year, we integrate IRS messaging, communication strategies and outreach efforts. This approach allows us to effectively deliver information and guidance to the public about the services and resources available to help taxpayers and their representatives understand and comply with their tax obligations.

In recent years, the IRS has employed two communication strategies that further focus our efforts to help taxpayers. First, to increase the number of taxpayers we serve, the IRS continues to educate our customers to the availability of self-help options on IRS.gov.

Second, in the last two filing seasons, there have been important changes taxpayers needed to know before filing. In response, we implemented the Get Ready campaign in fall 2016 and 2017. The campaigns focused on helping taxpayers understand, before filing season, the changes that may affect processing their tax returns and issuing refunds. These messages were also incorporated in communications throughout filing season. The IRS is continuing to build on these best practices in preparation for the 2019 filing season.

The IRS toll-free telephone line, which constitutes one of the world's largest customer service phone operations, is critical to taxpayer service. Taxpayers calling this line first navigate through automated menus informing them how to get their questions answered by selecting from menu options of frequently asked topics, such as refund status, transcripts, tax reform law, individual and business tax topics, and how to find information on IRS.gov.

In FY 2017, the IRS received more than 52 million taxpayer calls, with more than 40 percent, or about 23 million, handled by IRS customer service representatives. The rest were calls made to lines providing automated messages containing helpful tax information. Through April for FY 2018, the IRS received more than 34 million taxpayer calls, with more than 40 percent, or about 14 million, handled by IRS customer service representatives.

Recognizing that taxpayers may have questions about the Tax Cuts and Jobs Act provisions, the IRS will now answer tax reform tax law questions year-round, not just in filing season. The IRS also decided to route calls to dedicated CSRs for topics such as Basic Tax Reform (Itemized Deductions, Tax Rates, Child Tax Credit, etc.), Roth Conversions, Tax Rollover Period for Plan Loan Offset Amounts, Qualified Business Income Deduction, Disaster Areas Relief for 2016, Casualty Loss, Moving Expenses Deduction, and Affordable Care Act.

The IRS has also been successful in providing timely assistance to taxpayers who visit one of its Taxpayer Assistance Centers (TACs) around the country. This is the second year that all TACs are offering appointments in advance, a process that the IRS has found dramatically cuts wait times for TAC visitors. As in 2017, the IRS has had no reports of long lines during the 2018 filing season.

The IRS has also found this arrangement provides advantages to the taxpayer. When taxpayers call for an appointment, the IRS employee making the appointment can often help the taxpayers resolve their issue over the phone or refer them to the resources they need, eliminating the need to visit a TAC. For those that need an appointment, we can tell them what documents they need to bring with them, reducing the number of return trips. About half of those who called for an appointment resolved their issue without actually having to come in for an appointment.

In February 2018, the IRS implemented a new appointment scheduling tool which has further enhanced its ability to provide appointments. While the IRS encourages taxpayers to make appointments in advance, so they can be assured of quick and efficient service, it attempts to serve taxpayers who show up without an appointment.

The IRS provides a wealth of tax information on IRS.gov. In late summer 2017, it launched a redesigned IRS.gov website. The refreshed design improves how taxpayers interact with the IRS online. While tax issues can often be complex, the IRS.gov transformation should make it easier for taxpayers to navigate both the IRS website and tax law. One of the most important changes was to make IRS.gov mobile friendly. This means the site will resize and adapt based on the screen size or the type of device used, including a smartphone, laptop, tablet or desktop.

The new IRS.gov also improved content organization, highlighting the important tasks taxpayers come to IRS.gov to complete. Several links at the top of the pages give users one-click access to help, news, content in other languages and more. In addition to reorganizing content, IRS.gov now has drop-down menus on every IRS.gov page for those using a computer web browser. Each drop-down menu groups popular content options to eliminate scrolling — giving users quicker access to the information they need. We monitor how IRS.gov is performing, and user reactions, to better serve taxpayers and their representatives.

The IRS has invested significant resources in developing a series of online tools and applications so that those who prefer to interact with the IRS online can do so easily and securely. The plan is to continue investments in online tools and offerings and modernizing the taxpayer experience. Here are several key online applications the IRS has developed in response to increased taxpayer demand for online services:

- *“Where’s My Refund?”, an electronic tracking tool, is the most heavily used part of our website. Taxpayers used it about 278 million times in FY 2017, and already been used more than 275 million times this fiscal year.*
- *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 used this tool 15.5 million times in FY 2017 and 9.6 million times so far in FY 2018.*
- *Online Payment Agreement, a secure, safe, and easy process taxpayers can use to set up a payment plan and pay their tax obligations over time. A total of 798,000 online agreements were set up in FY 2017, and 571,000 have been set up so far this fiscal year.*
- *Direct Pay, which provides taxpayers with a secure, free, quick and easy online option for making tax payments. This tool was used 10.2 million times in FY 2017 and has been used 6.6 million times this fiscal year. The IRS is also continuing the development of online accounts at the IRS where taxpayers can log in securely, obtain the information they need about their account and interact with the IRS as needed.*

In 2016, the IRS 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. The IRS followed that up with another feature that lets taxpayers see recent payments posted to their account.

- b. How will IRS achieve similar results during the 2019 filing season to help taxpayers understand new requirements resulting from the tax law changes?

IRS Response: For filing season 2019, the IRS will continue the Get Ready campaign to provide the latest information to taxpayers. To reach as many people as possible, the IRS is using a variety of communications and outreach platforms. In January 2018, it started with the release of the withholding tables. The IRS followed up with the Withholding Calculator launch in February. For March, the IRS created a special campaign, Paycheck Checkup week.

The IRS will expand our communications through filing season 2019, adding information about other parts of the TCJA as guidance is issued. IRS outreach, communications and customer-facing employees, as well as external partners, will be equipped with the same messaging to generate awareness and consistently

encourage taxpayers to consider actions outlined on IRS.gov and Get Ready campaign.

Based on anticipated volumes, IRS will ensure that a sufficient number of CSRs are available to answer taxpayer questions and that all CSRs and all assistants in our TACs are trained on the new tax law. In addition, IRS will answer tax reform tax law questions year-round, not just during filing season.

The IRS will provide additional online tool enhancements as they are developed and tested with taxpayers and tax professionals. The IRS will continue to expand its outreach and communications effort through the summer and for the rest of 2018 so that taxpayers are informed before the start of the 2019 filing season. A critical piece of the strategy is working with third parties to help them share this information. During this summer, the IRS will conduct sessions across the country, reaching taxpayers and tax professionals. Additionally, the IRS will again conduct its Nationwide Tax Forums for tax professionals in five cities around the country, where the new tax law will take center stage.

3. There's been much discussion on the need for reforming and/or modernizing taxpayer services. However, at the same time, GAO recently noted that IRS's core tax processing system is over 50 years old, relies on archaic software, and is highly risky. GAO also noted that there is not a solid plan with realistic costs and milestones to replace the core tax processing system.
 - a. How is IRS balancing the need to reform and/or modernize taxpayer services while ensuring the critical internal systems supporting these taxpayer services are also appropriately modernized?

IRS Response: Delivering new services and modernizing existing services provided to taxpayers are both dependent upon our ability to stabilize and enhance our existing IT infrastructure and operations. In implementing modern technology and methods, the IRS will simultaneously improve the taxpayer experience and effectively advance modernization of IT infrastructure and operations. As efforts to modernize continue, the IRS will upgrade the currency of existing hardware and software, increasing redundancy, eliminating single points of failure, and building an IT workforce with the requisite skills. Success will be based upon effectively leveraging all resources and available sources of funding.

In several instances, modernizing services for taxpayers has included modernizing the internal systems supporting those services. One example in particular worth noting is the progress on the CADE 2 program to modernize the Individual Master File (IMF) core tax processing system. Through the CADE2 program, the IRS has delivered significant improvements to taxpayer services, with faster refunds, notices, and broader, agency-wide availability of more current taxpayer information. Through CADE2, the IRS is also addressing technical limitations imposed by the antiquated Assembly Language Code (ALC).

While we have many successes in delivering both modernized taxpayer services and modernized systems and infrastructure, the IRS has a great deal of work ahead of us. Modernization is a continuous process, and the IRS is taking every opportunity to leverage all available resources – not just Business Systems Modernization (BSM) – to continue to make progress. The IRS is enhancing our strategic planning processes and changing its approach to better integrate scheduled systems upgrades while implementing legislative mandates and BSM initiatives into an overall modernization strategy. The IRS is confident that this holistic approach will accelerate modernization and ensure all investments are planned and executed according to the IRS Strategic Plan.

4. Recent IRS officials have made public comments questioning the usefulness of the Form 990 Schedule B from organizations formed under IRC Section 501(c)(4) or (6), and acknowledging the risks that Schedule B filing poses to confidentiality. Given that this requirement, unlike that on organizations formed under IRS Section 501(c)(3), comes from IRS and Treasury rulemaking rather than the IRS, will IRS be reconsidering the requirement that 501(c)(4) and (6) organizations file a Schedule B?

IRS Response: On July 16, 2018, after careful review, the IRS and Department of the Treasury released Revenue Procedure 2018-38 limiting the requirement to file names and addresses on Schedule B to organizations described in Section 501(c)(3) or Section 527 of the Internal Revenue Code.

Ranking Member Wyden

1. **Office of Tax Policy comments on tax reconciliation.** During the consideration of the 2017 tax reconciliation bill, did the Office of Tax Policy or others at Treasury submit written comments to Congress? If so, and if such comments were not specifically submitted to the Senate Finance Committee Minority staff, please provide copies.

IRS Response: The IRS Office of Congressional Affairs-Legislation Branch did not provide written comments to Congress on the Tax Cuts and Jobs Act during its consideration.

2. **Conservation Easement Syndication.** Acting Commissioner and Assistant Secretary for Tax Policy Kautter, on March 29, 2017, I wrote to IRS Commissioner John Koskinen about the growth in abusive tax shelters involving the syndication of conservation easements. I asked the IRS to provide a report on the nature and scope of this problem. On July 13, 2017, the IRS provided a partial response that revealed participants in these syndication deals claimed deductions that were nine times the amount of their original investment. Subsequent preliminary responses indicate IRS may have lost billions of dollars to this tax shelter in hundreds of tax shelter transactions.

The Treasury Department issued Notice 2017-10, identifying these syndication transactions as abusive tax shelters and requiring participants to disclose their

involvement to the IRS. The Notice was also intended to deter future deals, however, media reports suggest these deals are still taking place.¹

- a. Historically, when the Treasury Department and IRS issue a Notice “listing” a certain transaction as an abusive tax shelter, the promotion and use of such schemes stops. Can you confirm whether this activity is continuing despite the Notice?

IRS Response: Current data suggests that the number of transactions has declined since the issuance of Notice 2017-10. The IRS, however, continues to receive additional disclosures, and it is still in the process of reviewing the disclosures received in 2018. As of May 31, 2018, the IRS has processed 552 of the 2018 Forms 8886 for this transaction and 1,928 Forms 8918. While forms continue to be processed, the current ratio from the 310 2018 Forms 8886 filed that provided both an investment and deduction amount is 4.91.

- b. Please describe whether the Administration has taken enforcement actions against the promoters of these abusive shelters identified via Notice 2017-10.

IRS Response: Approximately 40 of the top-tier-pass-through entities (i.e., the entity where the contribution transaction occurred, generally TEFRA partnerships) have open enforcement activity.

- c. Please describe whether the Administration has developed plans to take any enforcement actions against the promoters of these abusive shelters identified via Notice 2017-10.

- i. Enforcement actions against illegal syndicated conservation easement tax shelter transactions have proven challenging and time-consuming for the IRS. For example, earlier this month the Tax Court issued a ruling disallowing tax write-offs from a sham conservation easement transaction that occurred more than a decade ago.² While Notice 2017-10 may have extended the statute of limitations period for certain transitions, the time in which IRS can take enforcement actions on those tax shelter transactions grows shorter by the day. Please describe what actions IRS is taking to ensure that promoters of syndicated conservation easement tax shelter transactions are held accountable before the close of the statute of limitations.

IRS Response: The IRS is determining its specific enforcement strategy, which will also address entities that failed to properly disclose pursuant to the Notice. The information included in the disclosures, as well as experience with current inventory, shows the need for a varied approach

¹ Peter Elkind, “The Billion-Dollar Loophole,” ProPublica, December 20, 2017

² T.C. Memo. 2018-45

for this issue.

- d. Do you believe IRS currently has the tools needed to put an end to this abuse? Will Treasury propose regulatory or statutory changes to address these abuses if Notice 2017-10 and other tools are shown to be insufficient to curb the use of these tax shelters?

IRS Response: Enforcement in this area requires the significant assistance of appraisers and resources. The IRS is working to address this issue and will evaluate the results from its enforcement strategy and work with Treasury if additional regulatory or statutory changes are needed to curb misuse of the syndicated conservation easements.

- e. As Acting Commissioner, how high of a priority is it for IRS to stop this abuse?

IRS Response: The IRS is committed to pursuing those transactions that are abusive.

- i. Do you believe the transactions described in Notice 2017-10 are abusive on their face?

IRS Response: Notice 2017-10 sets forth that a transaction that results in a charitable deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment is a tax avoidance transaction.

- ii. To what extent will IRS challenge the tax benefits of each and every transaction covered by Notice 2017-10?

IRS Response: As stated above, IRS's experience with current inventory shows the need for a varied approach for this issue. The IRS is determining its enforcement strategy.

- f. As Assistant Secretary for Tax Policy, do you support Notice 2017-10?

IRS Response: Yes. Notice 2017-10 alerts persons involved in syndicated conservation easement transactions that disclosure responsibilities may arise from their involvement in the transactions. The Internal Revenue Service uses these disclosures as a significant tool in carrying out its enforcement responsibilities.

3. **New Taxes on Tax Exempts and Charities.** Acting Commissioner and Assistant Secretary for Tax Policy Kautter, the Republican tax bill³ passed in December 2017 imposed nearly \$10 billion in new taxes on charities and tax exempt organizations. Many

³ H.R.1, an Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.

of these provisions were carelessly drafted, leaving charities and other tax exempt organizations uncertain how the provisions will be implemented and how much tax they will have to pay. One of the most pressing sources of uncertainty is section 13702 of the Republican tax bill, which requires tax exempt entities to calculate unrelated business income tax (UBIT) separately for each trade or business. The provision, however, failed to make any attempt to define “trade or business,” causing significant confusion and uncertainty for charities and other tax exempt organizations across the nation.

Earlier this week the American Institute of Certified Public Accountants (AICPA) sent a letter to Congressional leaders stating that section 13702 of the Republican tax bill would be difficult or impossible to comply with without significant regulatory guidance from Treasury. The letter states “The burden of new section 512(a)(6) on tax-exempt organizations is substantial and nearly all tax-exempt organizations are affected.” This issue is further complicated by the fact that the provision went into effect January 1, 2018, just days after it became law. Charities and other tax exempt entities are in the process of making 2018 estimated tax payments, and are left guessing how to calculate the new tax.

- a. Did Treasury or IRS know that this provision as drafted would cause uncertainty to charities and other tax exempt entities without further regulatory guidance?

IRS Response: The Department of Treasury was in communication with Congress throughout the legislative process for H.R. 1 and is working diligently to implement the legislation. The Department of Treasury and the IRS appreciate the need for guidance that clarifies outstanding issues relating to newly enacted section 512(a)(6). The Second Quarter Update to the 2017-2018 Priority Guidance Plan includes guidance on the computation of unrelated business taxable income for separate trades or businesses. This guidance is one of the IRS’s top priorities.

- b. Did Treasury or IRS believe at the time of the Republican tax bill’s passage that they would be able to issue regulations fully clarifying this issue before the provision went into effect on January 1, 2018?

IRS Response: The Department of Treasury was in communication with Congress throughout the legislative process for H.R. 1 and is working diligently to implement the legislation.

- c. Did Treasury or IRS believe at the time of the Republican tax bill’s passage that they would be able to issue regulations fully clarifying this issue before the first 2018 quarterly estimated tax payment was due?

IRS Response: The Department of Treasury was in communication with Congress throughout the legislative process for H.R. 1 and is working diligently to implement the legislation.

- d. Did Treasury or IRS communicate to the Chairmen of the Senate Finance Committee or Ways and Means Committee (or their staffs) that this provision as drafted could cause uncertainty to charities and other tax exempt entities?

IRS Response: The Department of Treasury was in communication with Congress throughout the legislative process for H.R. 1 and is working diligently to implement the legislation.

- i. If yes, did Treasury or IRS suggest modified statutory language to further clarify the provision? Was any proposed language adopted in the final legislation?
- ii. If no, why did Treasury not communicate to Congress any concerns over the uncertainty this provision would cause?

- 4. **Minimum Standards for Paid Tax Return Preparers.** We continue to hear reports of unscrupulous tax return preparers preying on vulnerable taxpayers and pocketing the money. This is why Sen. Cardin and I introduced legislation to allow the IRS to require minimum standards for paid return preparers. Since the 1970s, Oregon has had minimum standards in place for tax preparers since the 1970s, and when GAO looked at the program, it found that returns filed by Oregon paid preparers were 72 percent more likely to be accurate than comparable returns filed in another state. Consequently, GAO has been recommending for years that the IRS set minimum requirements for paid preparers.

- a. Mr. Kautter, do you still see preparers taking advantage of taxpayers as a problem?

IRS Response: Yes, there are still preparers taking advantage of taxpayers. Whether the preparer is unscrupulous or just underprepared the outcome for the taxpayer and tax administration is much the same – a lack of compliance with tax obligations. To improve overall tax compliance, the IRS continues to support minimum standards for tax return preparers, as this will improve preparer competency and return preparation accuracy.

- b. Do you support legislation that would require minimum standards for paid preparers to protect taxpayers, such as was proposed in the President’s budget?

IRS Response: Yes. Such legislation would enable the IRS to ensure that all preparers have a basic level of competency and integrity. Additionally, greater oversight for return preparers would help the IRS identify unscrupulous preparers and develop more effective compliance and enforcement strategies.

- 5. **Cyber Attacks on IRS Systems.** Your predecessor, Commissioner Koskinen, testified before the Finance Committee in April 2016 that IRS computers “withstand more than 1 million malicious attempts to access them each day.”

Acting Commissioner and Assistant Secretary for Tax Policy Kautter, can you confirm for the Committee whether the rate of cyber attacks on IRS systems has increased to 2.5 million per day, as reported in POLITICO on April 10, 2018, and whether taxpayer data or IRS operations are at risk?

IRS Response: The IRS observes and mitigates more than 2.5 million unauthorized access attempts per day (>1 billion per annum), including denial-of-service attacks, unsuccessful intrusion attempts, probes or scans, and other unauthorized connectivity attempts. To date, the multi-layered defenses the IRS has in place have been extraordinarily effective in most cases. The bulk of these attempts have, presented minimal risk of exposure of taxpayer data and IRS operations.

What is the IRS doing to combat these attacks?

IRS Response: The IRS continues to leverage congressionally-provided funds to implement a multi-layered defense strategy. To date, the strategy has been successful, but the IRS is mindful that bad actors' evolving tactics mandate continual investment in defense.

The IRS has established 24x7x365 incident response capability with teams that perform around-the-clock intrusion and fraud analytics to identify, respond to, and mitigate emerging threats or fraudulent access/transactions. These employees are highly skilled across the realms of intrusion analysis, fraud analytics, and data analytics in general, with a very diverse skillset across the spectrum of cyber security.

The IRS leverages myriad integrated technologies and processes to provide proactive mitigation, timely detection, and rapid containment/response to identified cyber threats. Collectively, the IRS's enterprise security stack delivers safeguards and monitoring across disparate threat vectors ranging from publicly-accessible applications to endpoint devices. A snapshot of the enterprise security stack consists of the following:

- 1. Perimeter-based security infrastructure, which is comprised of firewalls, Intrusion Detection/Prevention sensors, Internet Proxy and Email Gateway Content Filtering, and Einstein 3 Accelerated. Collectively, these infrastructure components enforce traffic policy to permit connectivity that is explicitly authorized, while prohibiting all other connectivity.*
- 2. IRS's Publicly Accessible Internet Websites, which have dedicated security protections in place to authenticate users in a manner commensurate with the data being accessed, traffic shaping and web application firewalls to ensure accesses are compliant with protocol standards, and denial of service protections to mitigate excessive volume-based target attacks.*
- 3. Endpoint Protections, which serve as an additional line of defense through standardized common operating environments, antivirus and firewall to prevent split tunneling, patch/vulnerability analysis and remediation, software license metering and*

endpoint health monitoring to ensure applicable endpoint agents are operational and current.

4. *Analytics and Monitoring, which occur across the enterprise security stack using the big data ecosystem to provide normalization, aggregation, and correlation of datasets. Analysts can interrogate the data to answer specific questions and/or glean new insights or trends from the data.*

What can Congress do to assist?

IRS Response: *Congress can assist by funding the requests for Cyber Security initiatives in the 2019 Budget. Approval of Streamlined Critical Pay for technology positions is one of the most impactful steps Congress could take.*

6. **Failure of IRS E-File on Tax Day.** Mr. Kautter, we would like to get a full accounting of the circumstances behind the failure of IRS systems to accept electronically-filed returns that occurred early in the morning on April 17. The outage lasted 11 hours, with few details provided in the interim to the public and no direction given to taxpayers needing to file their returns.

As part of this accounting, can you tell us whether it is correct that this was simply a glitch in a piece of IRS hardware and not the result of interactions with any third parties? Is it correct that no taxpayer data was lost or compromised in any way? Has the backlog of transmitted-but-not-accepted returns since been processed by IRS? What specific processes have been put in place to ensure this type of outage will not happen again, especially on one of the busiest days of the tax filing season?

IRS Response: *Addressing your specific questions first:*

1. *As described in greater detail below, a firmware bug caused the mainframe to fail on Tax Day. The outage did not result from third-party actions.*
2. *The IRS did not lose or compromise any taxpayer data as a result of this outage.*
3. *The IRS processed the backlog within 24 hours of restoring the mainframe.*
4. *IBM and IRS deployed a script to find and automatically correct this storage array problem should it recur.*

Details and background:

The circumstances around the failure of IRS systems on April 17 are as follows. At approximately 2:57 AM EST on April 17, 2018, the IRS's core tax processing mainframe system used its automated "call home" capability to send an "alert" to the vendor, IBM, when it detected a deadlock condition after a warm start (system reboot initiated by the operating system). It sent a second automated alert to IBM at 4:45 AM EST. Meanwhile, at 2:24 AM EST, IRS's Information Technology Operations Command Center (ITOC) began receiving system-generated messaging and invoked our established processes to troubleshoot the problem. By 3:30 AM EST, IRS ITOC had detected problems with

several systems and submitted a work ticket. By 5:15 AM EST, IRS ITOC was in communication with the vendors (IBM and Unisys,) and technical assessments had begun. Extensive troubleshooting and system diagnostics testing by a joint IRS, IBM, and Unisys team revealed an extremely rare hardware failure caused by a firmware bug on the storage array (a subsystem component of the mainframe). A unique set of workload and timing conditions prevented deletion of data from the read cache (temporary memory), causing the cache to fill up. As a result, the system was unable to service any new requests for read or write cache, resulting in a deadlock condition that halted mainframe processing.

IBM product engineers cleared the deadlock condition on the storage array and then deployed a prevention script (temporary hardware instructions) to automatically run if any deadlock conditions were to occur again. By mid-afternoon on April 17, 2018, the mainframe was fully operational and, shortly thereafter, tax and payment processing resumed. Within 24 hours, the IRS had fully recovered and was current with processing, with no data corruption, data loss, or system breaches associated with this event. There have been no further occurrences of the deadlock condition.

While the IRS cannot guarantee that a rare hardware outage will never happen again, it has spent significant time assessing how we could reduce the effects of a similar failure. The IRS has worked with its vendors to improve the incident response and notification process. The IRS is also exploring options for increasing availability of mainframe systems. In accordance with our most recent IT Vision, the IRS is actively exploring solutions that will provide onsite resiliency to enable High Service Availability for our systems. The IRS is also considering ways to accept electronically-filed tax returns and payments independent of the mainframe systems to minimize risk should another mainframe interruption occur. Because the current backup system for an event of this magnitude requires considerable time to become operational, the IRS needs to invest in more failover options to increase mainframe systems availability.

And what new procedures will IRS implement (including postings on social media) to ensure that taxpayers and government officials are kept abreast of developments and given the timely direction they need to file their tax returns and comply with tax laws?

IRS Response: *The IRS released a variety of public messaging on April 17, 2018, informing taxpayers of the outage and providing direction on how taxpayers should file their tax returns.*

This included a widely-circulated mid-morning press statement and televised comments from the Acting Commissioner during the House Oversight and Government Reform Committee hearing. IRS issued a Quick Alert at 8.48 a.m. By mid-morning April 17, the IRS had also sent e-filing software providers the following message: “Currently, a number of IRS systems are experiencing technical difficulties. The IRS is looking into the issue and will provide updates as soon as possible. Taxpayers should continue filing their tax returns as they normally would.” The IRS added outage messages to affected tools on IRS.gov. On IRS telephones, the IRS instructed our toll-free representatives how to

respond to questions from callers. In addition, the IRS issued internal alerts under our Servicewide Electronic Research Program on both April 17 and 18 to internal audiences, which includes IRS Accounts Management and Field Assistance personnel, with messaging similar to the public messaging.

During the afternoon on April 17, the IRS began to publicize the filing deadline extension until midnight on Wednesday, April 18, 2018. This message was shared as quickly as possible. The IRS shared the announcement of the extension widely through a national news release, on IRS.gov, on Twitter, and through the news media and national tax association and partner groups, to ensure wide awareness of the additional day to file.

The IRS is looking for ways to focus additional attention on these sorts of issues should they occur in the future, including higher profile messaging on the front page of IRS.gov and wider use of social media.

7. **529 Plans.** As you know, the new tax law expanded IRC Section 529 plans to allow for qualified distributions from these plans for K-12 education expenses. These distributions can be made directly to the school, the student or the parent and are limited to \$10,000 per student per year. I am concerned that current practices do not allow for proper oversight of this expansion.

As you are aware, 529 plans are required to provide taxpayers receiving distributions and the IRS a Form 1099-Q recording the amount distributed from the plan that year. Qualifying colleges and universities are required to provide a Form 1098T to both the taxpayer and the IRS which report the expenses that were paid to the respective institution by the taxpayer for that year. This data is not collected or included on the annual Form 1040. Instead, taxpayers are only required to self-report to the IRS on Form 1040 when there are non-qualified distributions or distributions in excess of qualified expenses.

Please answer the following questions:

- a. How many individual tax returns were flagged and/or caught on audit each year for the past 3 years for reporting violations of 529 plan contribution rules? Please also provide the dollar amounts of these violations?

IRS Response: *The IRS is unable to provide this information, as its systems do not capture this information. Such income would be reported on Form 1040 as "Other Income," which may include other types of income.*

- b. Does the IRS match or track the 1098-T or 1099-Q information with the information that is filed by the corresponding taxpayer or is this only manually matched if the taxpayer is audited?

IRS Response: *The IRS currently matches both Forms 1098-T received from qualifying colleges and universities and Form 1099-Q from either a 529 or 530 education plan.*

- c. With the expansion to K-12 education expenses, how does the IRS intend to ensure that taxpayers are not taking distributions in excess of \$10,000 per student per year? Similarly, how does the IRS intend to ensure that multiple taxpayers are not claiming the same student? For example, parents and grandparents both claiming the same child up to the maximum amount of \$10,000 would be claiming \$20,000 in qualified distributions.

IRS Response: The IRS is currently considering options to address the additional compliance issues generated by the expansion of qualified expenses to K-12 education and the associated limitations. The ability of multiple taxpayers to claim tax-free distributions relating to the same beneficiary existed under the prior law.

- d. How does the IRS intend to determine the qualifying expenses for K-12 educational institutions for matching purposes since these institutions do not file a 1098-T with the IRS or the taxpayer?

IRS Response: Form 1098-T is filed under the authority of IRC Section 6050S. The filing of this form does not apply to IRC 529 under either prior or present law. Because the IRS will not have the information on Form 1098-T available, it determines qualifying expenses through a manual process if the return is audited and the issue warrants examination.

- e. Many states that provide state income tax deductions are claiming that their state laws must be modified to come into compliance with the federal law so their taxpayers will be able to continue to contribute to the same 529 plan. For example, a state has defined eligible 529 contributions to their plan to “colleges or universities” without a reference to IRC Section 529 so the change in IRC Section 529 for eligible expenses is not controlling. In these cases, can the IRS provide guidance that states do not have to participate in 529 plans and that the changes to 529 plan rules as contained in HR1 are not mandatory on the states. In other words, states do not have to change their laws so their citizens can continue to contribute to their 529 plans as they were able before the change in law.

IRS Response: P.L. 115-097 expanded the definition of “qualified higher education expense” for IRC Section 529 to include tuition expenses at or below the \$10,000 tax-year ceiling for K-12 schools. This expanded definition is applicable for Federal income tax purposes regardless of how states elect to manage their 529 plans. A state’s decision to participate in 529 plans or the deductibility of contributions to such plans will not impact the qualification of distributions for Federal tax purposes. The law did not modify the allowable contributions to 529 plans or related deductions provided by the states. Additionally, on July 30, 2018, The Internal Revenue Service and Department of the Treasury announced their intent to issue regulations on three recent tax law changes affecting popular 529 education savings plans.

- f. Are there any recommendations forthcoming from IRS for changes in law or technical corrections to ensure that taxpayers are compliant with the rules for the new expansion for K-12 expenses?

IRS Response: *Not at this time.*

Senator Thune

1. One of the biggest issues facing South Dakotans when it comes to their federal taxes has been the problem of tax-related identity theft. This not only affects those who have their identity stolen, but also those who find their refund delayed while the IRS verifies their identity. I was pleased to see the IRS's new partnership with the Federal Trade Commission to provide taxpayers with an online portal to report instances of tax-related identity theft.
 - a. Can you give us an update on the IRS's efforts to improve its defenses and help taxpayers fight ID theft?

IRS Response: *Refund fraud caused by identity theft (IDT) is one of the biggest challenges facing the IRS today, and the harm it inflicts on innocent taxpayers is a problem the IRS takes very seriously. The IRS has a comprehensive strategy focusing on preventing refund fraud, investigating these crimes, and assisting taxpayers victimized by tax-related IDT. Through the Security Summit, an unprecedented partnership between the IRS, the software industry, and the states, the IRS continues a unified battle against identity theft and works on collaborative solutions to combat stolen IDT refund fraud. IRS data shows significant improvements as fewer identity theft returns entered the tax system, fewer fraudulent refunds were issued, and fewer taxpayers were reporting themselves as victims of identity theft. The number of taxpayers reporting to the IRS that they are victims of identity theft continues to decline, it's fallen nearly 65 percent between 2015 and 2017. Also, during the 2015-2017 period, the number of confirmed identity theft tax returns fell by 57 percent with more than \$20 billion in taxpayer refunds being protected.*

As identity thieves evolve to become more sophisticated, the IRS has tightened its security in response to the increased threat. The IRS is making it harder for identity thieves to successfully masquerade as taxpayers and file fraudulent refund claims on behalf of these taxpayers. The IRS and partners recognize that large data breaches of personally identifiable information (PII) are difficult and frustrating for the victims and financial ecosystem. Large-scale data breaches are a reminder of the value of data for fraudulent purposes and identity theft. Over the last several years, the IRS IDT fraud filtering processes have remained effective even in situations of large losses of PII.

The IRS continues to endeavor to strike the necessary balance between preventing identity theft and ensuring that legitimate refunds are released quickly. The IRS implemented strategic initiatives to assist tax preparers with authenticating their clients who have been victims of a data breach, as well as identifying refunds that can

be released quickly, based on specific criteria. To stop fraudulent refunds from being paid, the IRS continually conducts analyses and looks for ways to improve and fine tune identity theft and fraud detection filters, as well as reduce the false detection rate. If the filter's selection criteria result in lower accuracy or performance, they may be revised or retired to minimize taxpayer burden.

The IRS uses several primary tools to combat tax-related identity theft and fraud. This includes tools specific to addressing taxpayers who have been victims of a data loss of federal tax information (FTI). Data losses involving FTI can be used to file returns that appear to be coming from the true taxpayer. IRS models and filters continue to be modified to address the level of sophistication used to file these fraudulent returns. The IRS has implemented the use of Dynamic Selection Lists, allowing the IRS to monitor specific accounts of taxpayers who have been victims of an FTI data breach when the data compromised would have a direct impact on federal tax administration. In doing so, the IRS is able to identify these suspicious returns more effectively, resulting in better protection for taxpayers' federal tax accounts and increased revenue protection.

In addition, there are multiple points in the return processing lifecycle to identify, prevent and assist possible IDT victims: pre-filing, at-filing, post-filing.

To prevent IDT returns from ever coming in the door (pre-filing), the IRS worked with tax software providers to improve the procedures that their new and returning customers must use to identify themselves. This minimizes the chance that the taxpayer's software provider's account can be taken over by identity thieves. This additional security is one of the most visible signs of increased protection to taxpayers because they will notice password requirements and other website security features.

To prevent taxpayers impacted by tax-related identity theft from becoming a repeat victim, the IRS issues an Identity Protection Personal Identification Number (IP PIN). The IP PIN authenticates the return received as belonging to the taxpayer.

The IRS has also implemented a variety of mechanisms to prevent criminals from using a deceased individual's identity information to perpetrate fraud. The IRS routinely locks the accounts of deceased taxpayers and have locked more than 30 million accounts so far.

In addition, IRS has taken the following actions to prevent fraud and enhance cybersecurity:

- *Sponsored the first Bureau-led Cybersecurity Community of Practice forum to enhance information sharing of Cybersecurity best practices. This led to two additional forums sponsored subsequently by the Mint and the Alcohol and Tobacco Tax and Trade Bureau.*

- *Established Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (ISAC) that provides a public-private partnership for participants to collaborate and share information; to detect and deter identity theft tax refund fraud; and to protect taxpayers.*
 - *Implemented network protection capability that blocked transmission of over 196,000 un-encrypted emails from leaving the IRS network, preventing the possible disclosure of sensitive data such as social security numbers and passwords.*
 - *Implemented and leveraged multiple cybersecurity threat countermeasures to prevent malware from being accessed or installed within infrastructure assets.*
 - *Expanded the Integrated Enterprise Portal (IEP) environment security protections and tools that significantly improved the detection and remediation of attempted external attacks aimed at IRS.gov via automated scripts, bots, and suspicious and malicious Internet Protocol addresses. The layered security tools protect taxpayer facing applications at the earliest entry point of the IRS infrastructure, which is the edge of the security and portal environment.*
 - *Implemented advanced analytics and fraud detection capabilities within the IRS IEP and eAuthentication environments to better protect access to the Get Transcript application.*
 - *Enhanced monitoring and analytic capabilities through investments in infrastructure, tools, and development expertise to accelerate continuous data monitoring.*
- b. Are there statutory changes that Congress needs to make to help you in those efforts to protect American's tax data and minimize the risk of tax-related identity theft?

IRS Response: The IRS appreciates the recent action of Congress enacting legislation requiring the accelerated filing dates for certain information returns.

Currently, under Internal Revenue Code sections 6011(e) and 6724, taxpayers that file 250 or more information returns, including Forms W-2, must file them electronically. The IRS uses this external third-party information, plus internal historical taxpayer filing data, business rules, and sophisticated algorithms, to identify potentially improper and erroneous refund claims, including tax-related identity theft.

2. The PATH Act required that the IRS delay refunds until February 15th for returns that claim the Earned Income Tax Credit or the refundable child tax credit in order to reduce fraud and improper payments. Additionally, the PATH Act required employers to file their copies of Forms W-2, W-3 and 1099-MISC for non-employee compensation by January 31st, rather than the end of February (or March if filing electronically) under prior law.
- a. With 2018 being the second year that the refund delay has been in place, can you share with the Committee any assessments of these new requirements and your efforts

to reduce fraud and improper payments with respect to the EITC and refundable child tax credit more broadly?

IRS Response: The earlier availability of Form W-2 data enhances the IRS's defenses against identity theft and refund fraud. The IRS conducted systemic verification of information reported on taxpayers' returns against third party information reporting earlier, before issuing refunds. In addition, the IRS utilizes the earlier Form 1099-MISC for non-employee compensation information as a variable in the filtering process.

This filing season, the IRS leveraged both the Return Review Program (RRP), and the PATH Act refund hold to automate and expand the selection of potentially fraudulent returns. Through February 15, the IRS identified approximately 312,000 returns claiming Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) with potential issues with overstated income or withholding. Some employers may obtain short 30-day extensions based on certain exigencies and submit their information returns after the January 31 due date. If the information comes in later and the return information is verified, the refund will be released.

About 3.5 percent of EITC related refunds were held for additional pre-refund compliance review by the Income Verification Program. Additional returns could also be selected for identity theft and pre-refund audit.

Other strategies to reduce improper payments with respect to refundable tax credits include education, outreach, and compliance efforts. The IRS is exploring enhancements and improvements to our enforcement efforts, while balancing taxpayer burden. For example, the IRS created a Refundable Credit Operational Strategy, which documents existing refundable credit efforts and identifies potential new activities that could reduce improper payments. The IRS also hosted an EITC Summit in June 2016, and a follow-up Summit in September 2017. These Summits provided us a wide variety of stakeholder perspectives on improving compliance.

Administering EITC represents a significant challenge for the IRS due to the nature of tax credits and the lack of available information to verify certain aspects of taxpayer eligibility at the time a return is filed. Many factors continue to serve as barriers to reducing overclaims in the EITC program. These include no single comprehensive government database or third-party data source that we can use to confirm all EITC eligibility requirements, complexity of the tax law; and declining IRS resources. These factors need to be addressed through legislative changes including correctible error authority so an examination is not required to adjust EITC.

As detailed earlier, while the PATH Act provisions helped to reduce refund fraud with respect to refundable credits, further statutory authority is needed including correctible error authority to address issues at the time of filing and increasing the

IRS's oversight authority over paid tax return preparers. The Administration has proposed both in its FY 2019 Budget.

- b. How has the earlier availability of Forms W-2, W-3 and 1099-MISC for non-employee compensation enabled the IRS to improve its matching of tax data to reduce fraud and improper payments? Are there any specific results you can share with the Committee?

IRS RESPONSE: See above.

- c. Are other statutory changes needed to help the agency stop improper refunds before they go out the door?

IRS RESPONSE: As detailed earlier, the IRS does not currently have correctable error authority to adjust erroneously claimed EITC based on the income discrepancies reported to the IRS. In addition, the IRS cannot address claims for the American Opportunity Tax Credit (AOTC) where a student has been claimed for more than the four-year limit, has attended an ineligible institution, or did not attend at least half-time. Therefore, the IRS addresses these errors through audits, which require significant time and resources. The Administration has proposed to increase IRS's authority to correct certain errors before refunds are issued.

The IRS appreciates Congress' enactment of legislation requiring accelerated filing dates for information returns.

Currently, under Internal Revenue Code sections 6011(e) and 6724, taxpayers that file 250 or more information returns, including Forms W-2, must file them electronically. The IRS uses this external third-party information, plus internal historical taxpayer filing data, business rules, and sophisticated algorithms, to identify potentially improper and erroneous refund claims.

In addition, increasing the authority to regulate paid tax return preparers, would help stop improper payments. Many taxpayers who claim these credits use professional tax preparers. If the IRS had the authority to ensure that paid preparers had certain minimal qualifications, that would improve the quality of returns that those preparers submit and thus, lower the number of errors that the IRS has to address in processing returns. The Administration included a proposal in its FY 2019 Budget.

Senator Nelson

1. As you know, in the wake of the hurricanes last year, the IRS delayed a number of reporting and filing deadlines. On behalf of Florida taxpayers, I want to thank the IRS for that relief. However, in response to a letter I sent the IRS following Hurricane Irma, the IRS said it could not halt its private debt collection program—which the National Taxpayer Advocate says often comes down hardest on low-income people already facing significant hardship.

Please explain why the IRS could not suspend its private debt collection program across-the-board for taxpayers in Federally-declared disaster areas.

IRS Response: The IRS determines the debt collection relief to be granted based on an assessment of the impacted area. For catastrophic disasters that affect entire states/territories, the relief granted includes suspending collection activity for a specified period of time in the designated disaster area, including initiating contact with the taxpayer. The IRS marks the accounts of taxpayers with the type of relief granted based on the last filed return showing an address in the designated disaster area.

The IRS granted relief from collection activity following Hurricane Irma in Florida from 9/4/2017 to 1/31/2018 and in Puerto Rico and US Virgin Islands from 9/5/2017 to 1/31/2018. On September 12, 2017, the IRS notified the public of expanded relief to any area designated by FEMA as qualifying for either individual assistance or public assistance in all 67 counties in Florida. <https://www.irs.gov/newsroom/tax-relief-for-victims-of-hurricane-irma-in-florida>

The issued notice provides that: “Affected taxpayers who are contacted by the IRS on a collection or examination matter should explain how the disaster impacts them so that the IRS can provide appropriate consideration to their case.” The private debt collection agencies are required to follow similar procedures to those that the IRS follows for debt collection. Thus, the private debt collection agencies were required to suspend all contact with taxpayers, cease all collection activity, and return the case to the IRS if a taxpayer requests relief verbally or in writing. The IRS alerts taxpayers through our press releases, postings on www.irs.gov, and published guidance.

2. I understand that the number of tax-related identity theft cases has declined in recent years, but criminals now have more information on us than ever before—with all the data breaches and privacy lapses that’s occurred in recent years.
What do you plan to do to stay on top of this crime and protect Americans from identity theft abuse or other scams, as criminals become increasingly sophisticated?

IRS Response: Refund fraud caused by Identity Theft (IDT) is one of the biggest challenges facing the IRS today, and the harm it inflicts on innocent taxpayers is a problem the IRS takes very seriously. To resolve IDT cases faster, the IRS centralized its IDT victim assistance policy, oversight, and campus case work under its new Identity Theft Victim Assistance organization. Benefits to this centralized approach include managing work using a common inventory system, reducing hand-offs between functions, improved case processing through streamlined, consistent procedures, and improved communication. In addition, the IRS resolves IDT cases faster using the toll-free hotline for IDT victims. All customer service representatives staffing this line are trained IDT specialists who can review the taxpayer’s case file and respond to the IDT victim’s call any time during business hours. For most cases, the average time to resolve a case is now less than 120 days. For more complex cases it can take up to 180 days to resolve. This is substantially less than a few years ago, when cases could take over 300 days to resolve.

In addition, IRS has taken the following actions to prevent fraud and enhance cybersecurity:

- *Sponsored the first Bureau-led Cybersecurity Community of Practice forum to enhance information sharing of Cybersecurity best practices. This led to two additional forums sponsored subsequently by the Mint and the Alcohol and Tobacco Tax and Trade Bureau.*
 - *Established Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (ISAC) that provides a public-private partnership for participants to collaborate and share information; to detect and deter identity theft tax refund fraud; and to protect taxpayers.*
 - *Implemented network protection capability that blocked transmission of over 196,000 un-encrypted emails from leaving the IRS network, preventing the possible disclosure of sensitive data such as social security numbers and passwords.*
 - *Implemented and leveraged multiple cybersecurity threat countermeasures to prevent malware from being accessed or installed within infrastructure assets.*
 - *Expanded the Integrated Enterprise Portal (IEP) environment security protections and tools that significantly improved the detection and remediation of attempted external attacks aimed at IRS.gov via automated scripts, bots, and suspicious and malicious Internet Protocol addresses. The layered security tools protect taxpayer facing applications at the earliest entry point of the IRS infrastructure, which is the edge security and portal environment.*
 - *Implemented advanced analytics and fraud detection capabilities within the IRS IEP and eAuthentication environments to better protect access to the Get Transcript application.*
 - *Enhanced monitoring and analytic capabilities through investments in infrastructure, tools, and development expertise to accelerate continuous data monitoring.*
3. Last year, I introduced the Identity Theft and Tax Fraud Prevention Act (S.606), which grants the Treasury Department authority to oversee paid tax preparers, among other reforms to protect taxpayers from tax-related identity theft. Unfortunately, the paid tax preparer provision is considered controversial by some Members of Congress. The provision, Section 115 of the bill, provides the following:

SEC. 115. MINIMUM STANDARDS FOR PROFESSIONAL TAX PREPARERS.

(a) In General- Subsection (a) of section 330 of title 31, United States Code, is amended--

(1) by striking paragraph (1) and inserting the following:

`(1) establish minimum standards regulating--

`(A) the practice of representatives of persons before the Department of the Treasury; and

`(B) the practice of tax return preparers; and', and

(2) in paragraph (2)--

- (A) by inserting `or tax return preparer' after `representative' each place it appears, and
 - (B) by inserting `or in preparing their tax returns, claims for refund, or documents in connection with tax returns or claims for refund' after `cases' in subparagraph (D).
- (b) *Authority To Sanction Regulated Tax Return Preparers-* Subsection (b) of section 330 of title 31, United States Code, is amended--
- (1) by striking `before the Department',
 - (2) by inserting `or tax return preparer' after `representative' each place it appears, and
 - (3) in paragraph (4), by striking `misleads or threatens' and all that follows and inserting `misleads or threatens--
 - `(A) any person being represented or any prospective person being represented; or
 - `(B) any person or prospective person whose tax return, claim for refund, or document in connection with a tax return or claim for refund, is being or may be prepared.'.
- (c) *Tax Return Preparer Defined-* Section 330 of title 31, United States Code, is amended by adding at the end the following new subsection:
- `(e) *Tax Return Preparer-* For purposes of this section--
- `(1) *IN GENERAL-* The term `tax return preparer' has the meaning given such term under section 7701(a)(36) of the Internal Revenue Code of 1986.
 - `(2) *TAX RETURN-* The term `tax return' has the meaning given to the term `return' under section 6696(e)(1) of the Internal Revenue Code of 1986.
 - `(3) *CLAIM FOR REFUND-* The term `claim for refund' has the meaning given such term under section 6696(e)(2) of such Code.'.

Does the Administration oppose this provision? If so, please explain why and provide suggested changes to address any concerns you may have about the provision.

IRS Response: The Administration's FY 2019 Budget includes a similar proposal to regulate paid tax return preparers. The above provision achieves the objective in the Administration's proposal.

4. *How will you work to ensure Public Law 115-97 (TCJA) will not provide a tax benefit to companies that outsource U.S. jobs?*

IRS Response: The tax policies advanced in TCJA, including a reduction of the corporate tax rate and modernizing our international system of taxation, will place U.S. companies in a more competitive position with their foreign counterparts, and encourage investment, repatriation of funds, and job growth in the United States.

Senator Bennet

1. Mr. Kautter, you and the IRS have a tall task ahead of you to implement the recently enacted tax legislation. I am very concerned that some of the provisions add significant complexity and uncertainty in ways that could lead both to an inability for businesses to invest until they understand the rules as well as significant revenue losses from gaming the system.
 - a. Do you have sufficient resources and authority to implement the tax legislation?

IRS Response: The IRS sincerely appreciates the funds, along with the multi-year authority and the flexibility to spread the funds between its appropriations, that Congress provided the IRS to implement TCJA. Based on the IRS's initial analysis of the provisions and the associated requirements, the initial \$320 million allocation, along with the requested \$77 million in FY 2019, are sufficient for FY 2018 and FY 2019.

- o How much additional funding do you think you will need?

IRS Response: At this time, this funding (\$397 million) is sufficient.

- o What additional authorities would be helpful?

IRS Response:

Streamlined Critical Pay Authority. The IRS Restructuring and Reform Act of 1998 increased the IRS's ability to recruit and retain a small number of key executive-level staff by providing the agency with streamlined critical pay authority. This allowed the IRS, with approval from Treasury, to move quickly to hire well-qualified individuals to fill positions deemed critical to the agency's success that required expertise of an extremely high level in an administrative, technical, or professional field. Executives hired under this authority included the former Chief Information Officer, a senior cybersecurity expert, the system architect, the director of the online systems development team, and other senior IT executives. This authority expired at the end of FY 2013. The last appointment made under Streamlined Critical Pay authority expired on September 29, 2017. Without this authority, the IRS continues to face challenges recruiting and retaining top-level talent, especially IT professionals who can help modernize its IT systems and protect taxpayer data from cyberattacks. The Administration's FY 2019 Budget proposes reinstating this authority through FY 2022.

- b. When do you think businesses will have the clarity they need to fully understand the implications of the tax law on their investing and hiring decisions? Can you give me a timeline on when you expect to be halfway done? 80% of the way done? 100% done?

IRS Response: The Department of the Treasury and the IRS appreciate the need for guidance that helps businesses determine the implications of the tax law on their investing and hiring decisions. We are working to provide guidance on these provisions as expeditiously as possible so that that taxpayers and tax practitioners may be aware of the changes in the new law and plan accordingly. The Second Quarter Update to the 2017 – 2018 Priority Guidance Plan contains specific timelines for the issuance of key guidance. Our goal is to issue guidance in at least proposed form on the most significant provisions of the tax reform bill by the end of this calendar year (2018).

2. We are already being made aware of the ways that firms will game the pass-through deduction. Unfortunately, this was entirely predictable when the legislation was jammed through the Senate without a single hearing or significant debate on massively important provisions like the pass-through deduction. Even with that hasty consideration, academics wrote up dozens of ways this provision and others would be gamed.
 - a. Can you tell me what you are doing to prevent “cracking and packing” where lawyers, doctors, and other high-income professionals who are not supposed to receive the deduction are shifting all of their profits into a separate entity that is eligible for the deduction?

IRS Response: The Department of Treasury and the IRS appreciate the need for guidance that clarifies outstanding issues relating to newly enacted section 199A. Proposed regulations under section 199A were released on August 8, 2018. The proposed regulations address “crack and pack” and propose a rule to prevent such strategies.

- b. Would you say that the pass-through deduction simplifies the tax code or makes it more complicated?

IRS Response: The IRS recognizes that all changes in law, including new tax provisions, involve a learning curve for those affected. The IRS and Department of Treasury are creating resources to assist taxpayers and tax practitioners in properly computing this deduction. In addition to the published guidance previously mentioned, the IRS is working on various communications, including revisions to forms, instructions and publications. Additionally, the IRS issued a Q&A along with the proposed regulations.

- c. As someone who has done a lot of tax planning yourself, do you think the pass-through deduction will reduce or increase tax planning activity?

IRS Response: As previously mentioned, all changes in law require some learning on the part of those affected. The Department of Treasury and the IRS are aware that taxpayers and tax practitioners are reviewing the new tax law provisions, reviewing their immediate impact and planning for the future. The IRS is working to provide guidance on these provisions as expeditiously as possible so that that taxpayers and tax practitioners may be aware of the changes in the new law and plan accordingly. Additionally, the proposed regulations mentioned above propose anti-abuse guidance to make certain that the rules are used appropriately.

Senator Brown

1. The House of Representatives has passed the VITA Permanence Act, which would allow the IRS to fund the Volunteer Income Tax Assistance (VITA) program with up to \$30 million using its own discretionary funds. According to the Congressional Research Service, the IRS collects about \$1 billion in miscellaneous fees that it can use however it wants.
 - a. What is the process by which the IRS decides how to direct those resources?

IRS Response: Congress establishes the funding level for VITA in the annual appropriation for Taxpayer Services. For example, \$15 million of the \$2.507 billion appropriated for Taxpayer Services in FY 2018 (P.L. 115-141) was designated for VITA grants, compared to \$12 million in FY 2015 (P.L. 113-235).

The IRS collects on average \$350 million in user fees annually and uses the budget authority from these fees to address high-priority business requirements including new legislation and preparations for the upcoming filing season, including taxpayer service activities. Over the last several years, the majority of the user fees have been allocated to critical IT operations necessary to implement and enforce legislative mandates, including the Patient Protection and Affordable Care Act, Foreign Account Tax Compliance Act, Trade Preferences Extension Act, and Achieving a Better Life Experience Act.

- b. If the VITA Permanence Act becomes law, will you work with my office to ensure this program has the funding it needs to carry out its services?

IRS Response: If the VITA Permanence Act becomes law, the IRS will work with the VITA partners to provide services to taxpayers.

2. On the issue of Private Debt Collectors, according to the Taxpayer Advocate, 28 percent of taxpayers who have had their debts assigned to private collectors have incomes below \$20,000, and 44 percent have incomes below 250 percent of the federal poverty level. The Taxpayer Advocate says you have legal authority to prevent collection on low-income taxpayers. Is that true, and if so, what steps is the IRS taking to shield low-income taxpayers from these collection efforts?

IRS Response: The Fixing America's Surface Transportation (FAST) Act, enacted in December 2015, requires the IRS to enter into qualified collection contracts for the collection of inactive tax receivables. The law is very specific about the types of cases that are excluded from the program. Accounts the IRS identifies as "currently not collectible" are not assigned to Private Collection Agencies (PCAs).

Excluding cases where the income reported on the tax return is below 250 percent of the Federal Poverty Level fails to consider that the taxpayer may have assets and, thus have

an ability to pay. For this reason, the IRS has not excluded these cases from being assigned to a PCA.

3. How are debt collectors instructed to prioritize collection? For instance, why are debt collectors targeting low-income individuals when underreported business income accounts for about twice the percentage of the tax gap as non-business income?

IRS Response: Section 32102 of the Fixing America's Surface Transportation Act (FAST Act) requires the IRS to use private collection agencies (PCAs) for the collection of outstanding inactive federal tax debts. Under the FAST Act, IRS is required to assign accounts to PCAs where taxpayers owe money but the IRS is no longer actively working the accounts.

Under the FAST Act, the IRS cannot assign accounts to PCAs involving taxpayers who are:

- *Deceased*
- *Under the age of 18*
- *In designated combat zones*
- *Victims of tax-related identity theft*
- *Currently under examination, litigation, criminal investigation or levy*
- *Subject to pending or active offers in compromise*
- *Subject to an installment agreement*
- *Subject to a right of appeal*
- *Classified as innocent spouse case*
- *In presidentially declared disaster areas and requesting relief from collection*

PCAs are required to work the accounts as they are assigned to them. PCAs do not know the reason why the taxpayer has outstanding federal tax debts. For example, the tax debt may be the result of the taxpayer filing a return but not paying the tax at the time of filing. The tax debt may be the result of a compliance action. PCAs only know the amount of the unpaid debt, the tax year and information about the taxpayer.

The PCAs offer payment arrangements to taxpayers in a manner consistent with IRS installment agreement procedures for similarly situated taxpayers who call the IRS. As is the practice within the IRS, a taxpayer's proposal to pay is accepted without questioning the ability to pay if the case meets certain criteria.

If a taxpayer reports an inability to pay in full or through a payment arrangement for any reason, IRS procedures require the PCA to return the account to the IRS.

4. On the issue of taxpayer service, according to the Taxpayer Advocate, the IRS is answering only 60 percent of taxpayer phone calls during this year's filing season, and is not answering questions after the filing deadline. From a funding perspective, what does Congress need to provide your agency so that taxpayers can have prompt, in-person help navigating the tax code?

IRS Response: The IRS achieved an 80% Level of Service on its phones during the 2018 filing season and projects achieving 75% for the full year. The resources requested for tax reform implementation will help ensure that the IRS can provide prompt help to taxpayers navigating the changes to the tax code during filing season 2019. In addition, Customer Service Representatives will be answering Tax Reform-related questions from taxpayers and representatives all year, rather than just in filing season.

Senator Heller

1. The Tax Cuts and Jobs Act represents a meaningful simplification and modernization of our outdated tax code. However, much work remains to be done to review existing and outdated regulations to ensure they do not place undue compliance burdens on individuals and businesses. One unduly burdensome regulation that still needlessly harms Nevadans is the current \$1,200 slot jackpot reporting threshold, which has been in place for approximately 40 years. Accounting for inflation, that number should be more than four times higher today – roughly \$5,000. Unfortunately, however, the threshold amount has remained static and, as a result, continues to impact many more of my constituents than was originally intended.
 - Are you willing to consider updating the current slot jackpot reporting threshold to reflect four decades of inflation?

IRS Response: As you know, the current \$1,200 threshold for reporting winnings from slot machine play was set in regulations published in 1977, despite the fact that section 6041 of the Internal Revenue Code, the operative statute, provided in 1977 (and currently provides) that, generally, a payment of income of \$600 or more made in the course of a trade or business is subject to information reporting. When the IRS published proposed regulations in 2015 to update the regulations for information reporting for bingo, keno, and slots, it asked for public comments regarding the feasibility of reducing the reporting thresholds to \$600 at a future time. The IRS received numerous comments in response to this request. Almost all of the comments recommended against lowering the thresholds, and many recommended raising the thresholds. None of the comments, however, provided information that could be used as a basis for raising the threshold or determining what a higher threshold should be. As there has not been congressional action on these thresholds in over 40 years and we have no basis on which to determine what a new threshold should be, the IRS finalized these regulations in 2016, retained the status quo, and did not change the reporting thresholds. Notably, the final regulations provide an optional aggregate reporting method and simplified payee identification requirements, both of which lessen the information reporting burden for the industry.

2. I have long been a champion of policies that promote the development of alternative energy technologies like solar and geothermal, and I was instrumental in securing the enhanced solar investment tax credit (ITC) last Congress. However, while this provision was signed into law nearly three years ago, stakeholders in my home state of Nevada and across the country are still waiting to receive guidance on the qualification standard and phasedown. When can we expect to receive this guidance on the solar ITC?

IRS Response: *The IRS issued guidance on the solar tax credit (Notice 2018-59) in June 2018.*

Senator Whitehouse

1.) At the hearing, we discussed the IRS's role in combatting foreign election spending. I asked about what the IRS does to prevent foreign nationals from laundering money through opaque LLCs or 501(c)(4) organizations and into our elections.

- a. Thanks to Senator Wyden's inquiries, we have learned that the National Rifle Association (NRA) accepts foreign donations, although the NRA claims that none of those donations go toward political expenditures. The NRA told Senator Wyden "Our review of our records has found no foreign donations in connection with a United States election, either directly or through a conduit." Has the IRS investigated or is it investigating this claim?

IRS Response: *As a general rule, section 6103 of the Internal Revenue Code (IRC) precludes the disclosure of whether the IRS investigated or will be investigating a particular taxpayer's conduct under the internal revenue laws.*

- b. 501(c)(4) organizations are required to disclose their donors to the IRS, what does the IRS do with that information?

IRS Response: *Treasury regulations require section 501(c)(4) organizations to include Schedule B, Schedule of Contributors, with annual information returns on Forms 990/990-EZ. This regulation also authorizes the Commissioner to grant relief from those requirements. On July 16, 2018, the Commissioner exercised his discretion with the publication of Revenue Procedure 2018-38 limiting the requirement to file names and addresses on Schedule B to organizations described in Section 501(c)(3) or Section 527 of the Internal Revenue Code. These organizations must continue to collect and keep this information in their books and records and to make it available to the IRS upon request, when needed for compliance purposes.*

- c. What does the IRS do when a potential-shell corporation is listed as a donor to a 501(c)(4)?

IRS Response: *The IRS maintains or obtains information for use, as needed, in compliance matters. The Federal tax consequence of the characteristics of any corporate donor would depend on the facts and circumstances of the particular case.*

- d. What resources do you devote to policing the rules about 501(c)(4)s?

IRS Response: *The IRS administers and enforces the tax laws as in effect. The TE/GE FY 2018 Work Plan, dated September 28, 2017, sets forth the Exempt Organizations Division's FY 2017 accomplishments and its plan for FY 2018 to continue to be an organization whose key elements are "efficiency, effectiveness, and transparency."*

- 2.) Question 15 of IRS Form 1024, the application for recognition of tax exemption, asks: “Has the organization spent or does it plan to spend any money attempting to influence the selection, nomination, election, or appointment of any person to any Federal, state, or local public office or to an office in a political organization?” Tax-exempt organizations are also required to report political activity annually on Form 990. Both forms are signed under penalty of perjury. 26 U.S.C. § 7206

- a. What is the process by which the IRS would initiate and pursue a false statements investigation under 26 U.S.C. § 7206?

IRS Response: The IRS follows processes set forth in the Internal Revenue Manual (IRM) to initiate a criminal investigation. See IRM 9.4.1, Investigation Initiation (3/2/08); IRM 25.1, Fraud Handbook; IRM 9.1.3.3.7.1, 26 USC § 7206(1) (False or Fraudulent Return, Statement, or Other Document Made Under Penalty of Perjury) – Elements of the Offense (05-15-2008).

- b. Does the IRS review public FEC filings to see if organizations are reporting conflicting data regarding political spending?

IRS Response: Depending on the facts of any particular case, the IRS considers information that is necessary to determine if an organization meets the applicable requirements for tax exemption.

- c. If an organization says on a 1024 or 990 form that it has not engaged in any political activity or that it has no plans to, and you subsequently find out that it has engaged in political activity, is that sufficient to initiate a § 7206 investigation?

IRS Response: Evidence that a filer made a statement “which he does not believe to be true and correct as to every material matter” may lead to a § 7206 investigation. If an IRS function identifies a potential violation of § 7206, it follows established procedures to refer the case to IRS’s Criminal Investigation Division. See Internal Revenue Manual 4.75.35.6, Criminal Referrals (8/19/16).

- d. Where there is an obviously false statement regarding political activity on a Form 1024 or 990, how does the IRS determine whether that statement rises to the level of materiality required under 26 U.S.C. § 7206?

IRS Response: In the given circumstances, the IRS reviews evidence whether a filer made a statement “which he does not believe to be true and correct as to every material matter”.

- e. Do you think there is something wrong where a group may be reporting millions of dollars in spending to the FEC, but zero to the IRS?

IRS Response: IRS administers and enforces the provisions of the Internal Revenue Code (IRC). The IRC and rules thereunder require information to be reported to the IRS on Form 1024 (now Form 1024-A) and Form 990 as necessary to determine

whether an organization meets the applicable requirements. IRS is unable to confirm that Federal tax reporting requirements are the same as the reporting requirements of other agencies.

- f. Does the absence of bright-line rules for political spending by 501(c)(4) groups make prosecutions more difficult?

IRS Response: The IRS administers and enforces, and taxpayers are required to comply with, the tax laws as in effect. Section 501(c)(4) provides exemption, in part, for “[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.” An organization “is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.” Treas. Reg. § 1.501(c)(4)-1(a)(2)(i). The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office (political campaign intervention, or “PCI”). Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii). Although engagement in PCI is not prohibited for these organizations, the primary activities of organizations described in section 501(c)(4) must be the promotion of social welfare.

In addition, section 501(c)(4) organizations that engage in PCI may be subject to tax under section 527(f) on their exempt function expenditures. Whether an organization is engaged in PCI depends upon all the facts and circumstances of each case. Applicable rules contain examples illustrating facts and circumstances considered in determining whether activities are PCI. See, e.g., Rev. Rul. 2004-6; Rev. Rul. 2007-41. The analysis reflected in these revenue rulings for determining whether an organization has engaged in PCI, or has expended funds for a section 527 exempt function, is fact-intensive. Generally, criminal prosecutions require proving willful evasion of the tax laws.

- i. Do you think there should be a bright line rule?

IRS Response: The IRS will administer any statutory direction on this matter.

Senator Cantwell

IRS Funding/Customer Service

In FY 2019, the Administration requested \$2.24 billion the budget for taxpayer services – a cut of \$215 million.

1. What steps can the IRS take to the same level of customer service to taxpayers at a time of increased complexity, especially for pass through businesses, as a result of the 2017 tax bill?

IRS Response: The FY 2019 Budget request was prepared prior to the enactment of TCJA and did not take into account the \$397 million the Administration subsequently requested in FY 2018 for implementation and service requirements through FY 2019. The IRS plans to

hire the necessary number of Customer Service Representatives (CSRs) to address the expected increase in call volume during filing season 2019. IRS is now answering tax reform tax law questions year-round, including questions on the new Qualified Business Income Deduction for pass-through businesses. IRS and the Department of the Treasury issued proposed regulations in August 2018, along with accompanying materials, to help businesses understand the new pass-through deduction changes.

2. About 60% of customer service calls are handled by automated responses. The IRS also provides in person assistance at Taxpayer Assistance Centers (TAC's). For taxpayers who wish to talk to an IRS employee in 2019 during the next filing season, is there any plan to expand the network of TAC's so that taxpayers will have the resources and access to information they need to file their taxes under the new law?

IRS Response: The IRS continues to evaluate the needs and options for delivering services to taxpayers. We routinely review face-to-face Taxpayer Assistance Center (TAC) locations. During these reviews, we analyze taxpayer access to face-to-face service in the community and determine how to effectively meet taxpayer demand and preferences for service.

We also offer virtual face-to-face services where taxpayers interact with live assistor remotely via high-resolution video capabilities at partner locations. So far, this calendar year, nine Virtual Service Delivery (VSD) systems were installed at community partners, for a total of 39 locations around the country. These include two new VSD partner locations where face-to-face taxpayer services were not previously available in the community. The IRS has identified additional VSD locations and is planning and preparing for the installation.

Seniors and low to moderate-income taxpayers can get free help with return preparation through the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs during the filing season. At over 11,500 sites, taxpayers may obtain free face-to-face help preparing their tax returns. These programs provide services to primarily low to moderate income taxpayers, senior citizens, persons with disabilities, those with limited English proficiency, those located in rural locations, and Native Americans. TCE offers free tax preparation for all taxpayers, particularly those who are 60 years of age and older, specializing in questions about pensions and retirement-related issues unique to seniors.

IRS Private Debt Collectors

And the debt collectors were mostly targeting lower-income taxpayers, including some who are receiving Social Security Disability Insurance (SSDI) – these people are not supposed to be part of the program. The report also noted that of the 4,100 taxpayers who made payments after their debts were assigned to private collectors, 1,100, or 28 percent, had incomes below \$20,000.

3. What steps can the IRS take to ensure that taxpayers who also receive Social Security Disability Insurance (SSDI) are not targeted by private debt collection?

IRS Response: The Fixing America's Surface Transportation (FAST) Act, enacted in December 2015, requires the IRS to enter into qualified collection contracts for the collection of inactive tax receivables. The law is very specific about the types of cases that are excluded from the program. Accounts the IRS identifies as "currently not collectible" are not assigned to Private Collection Agencies (PCAs). Although the statute does not exclude from the program those taxpayers receiving Social Security Disability Income (SSDI) or Supplemental Security Income (SSI), the PCA will return any account to the IRS when, during discussion with taxpayers, they give any indication of receipt of SSDI or SSI, or when the taxpayer, for any reason, states they are unable to pay. As of January 25, 2018, the PCAs returned 2,109 accounts because the taxpayer self-reported receipt of SSDI or SSI.

The IRS provides oversight of the PCAs' taxpayer interactions, contractual compliance, and adherence to policies and procedures. Overall, the PCAs are performing at a 98.5% accuracy rate. The IRS will continue to provide this oversight and consider improvement opportunities to address any concerns if they arise.

Cybersecurity and Identity Theft

4. Can you describe the steps you are taking to prevent tax return fraud and assist the taxpayers who are tax identity theft victims while the customer service budget at the IRS is being cut?

IRS Response: Refund fraud caused by Identity Theft (IDT) is one of the biggest challenges facing the IRS today, and the harm it inflicts on innocent taxpayers is a problem the IRS takes very seriously. To resolve IDT cases faster, the IRS centralized its IDT victim assistance policy, oversight, and campus case work under the new Identity Theft Victim Assistance organization. Benefits to this centralized approach include managing work using a common inventory system, reducing hand-offs between functions, improved case processing through streamlined, consistent procedures, and improved communication.

In addition, the IRS resolves IDT cases faster using its toll-free hotline for IDT victims. All customer service representatives staffing this line, are trained IDT specialists who can review the taxpayer's case file and respond to the IDT victim's call anytime during business hours. For most cases, the average time to resolve a case is now less than 120 days. For more complex cases it can take up to 180 days. This is substantially less than a few years ago, when cases could take more than 300 days to resolve.

To prevent taxpayers impacted by tax-related identity theft from becoming a repeat victim, we issue an Identity Protection Personal Identification Number (IP PIN). If an attempt is made to e-file a return without entering the IP PIN or if an incorrect IP PIN is entered, the return is rejected until the correct IP PIN is entered.

5. What additional resources do you need to protect those systems and keep our taxpayer account information secure?

IRS Response: The 2019 President's Budget included a program integrity cap adjustment proposal that includes funding for automating online fraud prevention capability to deliver

actionable intelligence in near real time. The IRS also needs funding and flexibility to hire additional IT specialists skilled in data analytics/science and interrogating voluminous data, and additional cyber security specialists and the 2019 Budget also included a request to extend the Streamlined Critical Pay authority program.

6. What is the IRS doing specifically to help small businesses to prevent them from falling victim and mitigating any impact if their business identity becomes compromised?

***IRS Response:** The IRS has increased business identity theft protections by expanding the upfront filtering and modeling to identify potential identity theft in business returns. In addition, the IRS continues to take a variety of steps to help make small businesses aware of the threat from identity theft. This has been a key component of the Security Summit external outreach and communications effort. The Security Summit is a partnership between the IRS, state tax administrators, and the private sector tax community and tax professionals, to battle tax-related identity theft. The IRS Security summit brings Federal, State, and tax preparation industry together to work together to eliminate tax refund fraud.*

Here are some examples of our communications-related work touching on small businesses and identity theft:

***2018 Small Business Week.** During national Small Business Week in May, the IRS issued a series of news releases aimed at small businesses, including the following May 3 news release: *IRS urges small businesses: Protect IT systems from identity theft.* The release links to a variety of resources, including: *Has your business become the victim of a data security breach?**

***e-News for Small Business.** e-News for Small Business is an IRS electronic newsletter distributed regularly to more than 300,000 subscribers. This year, the newsletter has included several security-related articles to help raise awareness among small businesses about identity theft and related issues.*

***Protect Your Clients; Protect Yourself.** The ongoing Protect Your Clients, Protect Yourself campaign has helped educate the small business community about identity theft and what to do in the event a business identity or its information is compromised. An outgrowth of the Security Summit, the campaign launched in 2016 with a series of news releases and tax tips. The campaign initially focused on tax professionals, but has resources helpful to all small businesses.*

***Don't Take the Bait.** As part of the Security Summit effort, the IRS, state tax agencies and the tax industry sponsored an educational series during summer 2017 called Don't Take the Bait. The series, part of the "Protect Your Clients, Protect Yourself" campaign, raised awareness of the critical need for tax professionals – as well as small business and taxpayers – to increase their computer security and be cautious when reviewing their inbox – specifically with regard to successful email scams, dubbed "spear phishing," that impersonate friends, customers, or companies.*

*At the beginning of the 2017 holiday shopping season, the IRS and its Security Summit partners conducted **National Tax Security Awareness Week** with a series of 10 news releases and tax tips to encourage both individual and business taxpayers to take steps to protect their tax data and identities in advance of the 2018 filing season. This work with state and private-sector partners, local consumer groups, law-enforcement agencies and other government groups led to 32 different events across the country, more than 50 local television stories and coast-to-coast media attention. 24 state revenue departments participated in the effort.*

7. Has there been an effort to bring in small businesses into this as they have a much harder time recovering if their identity is stolen or their credit is compromised?

IRS Response: Security Summit initiatives have focused on protecting all taxpayers, including small businesses from identity theft. As stated above, outreach and educational efforts have focused on making all businesses, including small businesses aware of the potential threat of identity theft and steps businesses should take to protect themselves. The IRS, however, has conducted extensive outreach to make all businesses aware of the potential threat of identity theft. For example, the IRS issued a Newswire article on December 1, 2017 (Issue Number IR-2017-198), as part of the outreach communication efforts specifically focused on small businesses.

The IRS has also addressed protecting clients at the Nationwide Tax Forums.

8. Have you brought in business credit reporting agencies into the working groups to identify the right data points to help protect businesses in real or near-real time?

IRS Response: Business credit reporting agencies are not currently participants in the Security Summit working groups. The IRS, however, worked with industry, states, and financial institutions to identify characteristics or elements of business returns that would be helpful in the identification of identity theft. In addition, the IRS established a payroll sub-working group to engage payroll companies in the fight against identity theft.

Solar Investment Tax Credit

In December 2015, Congress passed The Protecting Americans from Tax Hikes (PATH) Act of 2015, which extended the tax credits for wind and solar production. The bill also made changes regarding the placed in service definitions so that investors can start earning the credit when construction begins. The IRS has provided guidance for wind energy facilities PTC in June 2016. The solar energy facilities ITC has not yet received any guidance from the IRS

- The Protecting Americans from Tax Hikes (PATH) Act was enacted in 2015 and included a provision to extend and phase out the wind production tax credit (wind PTC) and the solar investment tax credit (solar ITC) and to change the qualification for to the solar ITC to the start of construction.
- The wind PTC received its guidance in 2016.

- Businesses need certainty and clarity. Solar companies are bidding on projects now and need to know how the changes from the PATH Act would apply. Guidance is needed from the IRS to provide that certainty and clarity.
9. Given that it has been 2.5 years since the provision for the solar ITC was enacted, will this guidance shortly?

IRS Response: Guidance on the solar tax credit was issued in June 2018 ((Notice 2018-59).

Senator Casey

1. Taxpayer Assistance Centers, which operate across Pennsylvania and across the country, are a critical service provided by the IRS. I note that TACs now operate by appointment. This is a recent change, and my staff has heard of individuals being turned away from TACs for lack of an appointment. In states like mine, taxpayers may drive quite a distance to go to a center to receive tax assistance.
- a. What kind of procedures do you have in place for individuals who show up without an appointment?

IRS Response: Whenever possible, the IRS attempts to accommodate and serve all taxpayers that come into a TAC without an appointment, if there is capacity between scheduled appointments. The IRS also serves individuals by exception in cases of hardship, including senior citizens or those who have traveled long distances. For fiscal year 2018 through April 30, TACs served more than 1.6 million customers, of which more than 6 percent were served without an appointment. Taxpayers do not need an appointment to make a payment by check or money order, drop off a current year tax return, and get forms.

- b. Do you have special procedures for seniors or other individuals who may have difficulty coming back to a TAC at a later date?

IRS Response: See Above

2. In your testimony you said the total number of taxpayers served at TACs this year through March 31 is 790,000, of which about 6% who visited a TAC without an appointment. Please provide state by state data both for total taxpayers served by TACs and also those served by TACs without an appointment. Please also provide data on the number of taxpayers served prior to the requirement for an appointment, as well as data on how many taxpayers were turned away from a TAC this year because they lacked an appointment?

IRS Response: The chart below shows the total number of taxpayers served face-to-face at TACs by state, DC & Puerto Rico for fiscal years 2015 – 2017.

4.12.18 SFC QFRs

State	FY 2015	FY 2016	FY 2017	State	FY 2015	FY 2016	FY 2017
AK	23,000	18,700	9,800	MT	31,700	24,400	11,100
AL	114,700	86,500	58,700	NC	121,700	96,400	95,000
AR	40,200	38,000	23,900	ND	29,900	27,500	18,400
AZ	143,200	129,100	68,900	NE	37,500	35,200	21,800
CA	702,800	540,900	409,900	NH	25,600	21,000	12,300
CO	62,000	53,500	40,500	NJ	169,200	146,000	106,300
CT	69,900	55,700	44,100	NM	62,200	36,300	18,700
D.C.	30,000	23,300	20,900	NV	78,000	53,100	31,200
DE	23,700	20,900	11,400	NY	343,600	286,500	214,800
FL	387,100	313,300	277,000	OH	105,900	106,400	76,300
GA	201,400	177,000	139,400	OK	54,300	58,500	35,900
HI	29,500	11,600	6,900	OR	74,100	63,300	59,200
IA	35,700	24,900	16,500	PA	149,900	123,100	93,700
ID	27,500	22,900	15,900	Puerto Rico	62,700	63,900	52,900
IL	170,900	139,800	108,600	RI	25,200	16,400	12,800
IN	97,400	82,300	53,800	SC	74,500	59,400	44,900
KS	30,900	24,100	19,200	SD	18,400	14,500	10,900
KY	51,500	37,000	29,300	TN	107,200	84,200	62,200
LA	124,800	93,900	66,300	TX	525,700	439,000	327,300
MA	67,000	59,700	40,700	UT	49,100	36,600	24,700
MD	119,100	87,500	60,700	VA	114,200	86,100	52,600
ME	38,000	32,500	18,000	VT	6,780	4,180	3,240
MI	71,800	59,300	39,300	WA	141,500	114,000	77,900
MN	62,300	51,000	34,600	WI	50,300	41,900	33,100
MO	135,900	108,000	54,700	WV	34,300	28,900	16,700
MS	60,700	49,800	32,100	WY	19,900	19,000	11,000
				Total	5,434,380	4,426,980	3,226,040

The chart below shows total number of taxpayers served face-to-face at TACs with and without an appointment and total number of taxpayers served face-to-face at TACs without an appointment by State, DC, and Puerto Rico for fiscal year 2018 from 10/1/2017 to 4/30/2018.

State	Taxpayers served face-to-face at TACs with and without an appointment	Taxpayers served face-to-face at TACs without an appointment	State	Taxpayers served face-to-face at TACs with and without an appointment	Taxpayers served face-to-face at TACs without an appointment
AK	5,780	1,380	MT	6,380	580
AL	30,800	2,560	NC	48,200	3,760
AR	10,100	1,880	ND	10,900	650
AZ	40,900	4,140	NE	11,100	1,140
CA	230,500	15,100	NH	6,750	1,390
CO	21,600	1,000	NJ	52,200	2,520
CT	23,700	1,560	NM	9,700	110
D.C.	12,100	270	NV	16,800	170
DE	5,120	410	NY	96,700	5,030
FL	144,600	9,130	OH	40,700	4,420
GA	72,900	6,070	OK	17,800	2,820
HI	4,220	100	OR	32,600	3,270
IA	8,730	920	PA	43,600	4,210
ID	7,640	750	Puerto Rico	25,200	1,080
IL	59,200	1,520	RI	6,350	300
IN	24,100	3,400	SC	27,100	2,580
KS	10,400	1,650	SD	5,870	540
KY	15,100	1,040	TN	32,800	1,650
LA	25,800	3,330	TX	172,100	10,180
MA	19,000	1,860	UT	12,700	550
MD	30,800	1,310	VA	18,800	1,040
ME	9,100	990	VT	2,180	180
MI	19,800	1,310	WA	43,000	1,820
MN	17,200	1,650	WI	16,400	480
MO	23,400	860	WV	8,400	650
MS	13,800	2,280	WY	4,700	820
			Total	1,655,420	118,410

Before requiring an appointment, in FY 2015 a total of 5.4 million taxpayers were served face-to-face at TACs. The IRS does not have data of how many taxpayers may have been unable to obtain service at a TAC because they lacked an appointment. This is difficult information to capture as some taxpayers choose not to wait; some find assistance through other channels such as IRS.gov or toll-free telephone lines; and some obtain their answer through information sources provided at the TAC.

3. This Committee has discussed cybersecurity and tax-related ID theft prevention quite a bit in the last few years. This threat is even more pronounced with the massive Equifax data breach last year.

Can you discuss investments you've made to better protect taxpayers' personal information?

IRS Response: The IRS has made significant investments in predictive analytics, forensics, and monitoring capabilities. The IRS has developed indicators/models to detect and/or prevent fraudulent activity in online applications. The IRS conducts in-depth analysis of anomalous behavior of online applications and coordinate our findings for appropriate and timely response. Going forward, the IRS will enhance these capabilities with investments in next generation advanced analytics, to generate actionable threat intelligence in near real-time.

Information Technology

Information Technology (IT) Budget Portfolio Investment Plan (PIP) Process



March 31, 2017



IT Budget – Portfolio Investment Plan (PIP) Process Description Manual Transmittal

Effective Date

Upon signature

Purpose This Process Description establishes the IT Budget – PIP Process for IT.

Material Changes This transmits a new IT Budget – PIP Process Description.

Effect on Other Documents This is the initial release and publication of the IT Budget – PIP Process description.

Audience This Process Description is applicable to all IT organizations, contractors, and other stakeholders having responsibility for developing and maintaining IT processes.

Signature

A handwritten signature in black ink, appearing to read "Bryan L. Musselman", is written over a horizontal line.

Bryan L. Musselman
Director, Financial Management Services

Change History				
Version Number	Version Date	Change Description/Purpose		
		Location	Type	Nature of Change(s)
0.1	3/31/2017	All	A	Initial Version of Document

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Table of Contents

1	Introduction	5
1.1	Administration	5
2	Overview	6
2.1	Process Description	6
2.1.1	The IT Financial Management Services Process.....	6
2.1.2	The PIP Process	6
2.2	Goal	6
2.3	Objectives	7
2.4	Related Process References and Artifacts	7
3	Process Workflow	8
3.1	Main Process Diagram.....	8
3.2	Inputs	8
3.3	Outputs	10
3.4	Activities.....	13
3.5	Roles.....	15
4	Process Control.....	18
4.1	Controls.....	18
4.2	Metrics	18
4.3	Policies	18
4.4	Tailoring Guidelines	20
5	Training	21
6	Appendix.....	22
6.1	Acronyms.....	22
6.2	Glossary.....	23

List of Figures

Figure 1. PIP Process	8
-----------------------------	---

List of Tables

Table 1. PIP Process Inputs.....	8
Table 2. PIP Process Outputs	10
Table 3. PIP Process Activity Description	13
Table 4. PIP Roles	15
Table 5. PIP Process Controls	18

1 Introduction

This document describes the formal process for implementing the requirements for the IT Budget – PIP process. It provides an operational definition of the major process components and describes how to perform each step. This document also describes the logical arrangement of steps that are essential to successfully completing the process and achieving a desirable outcome.

The IT organization has implemented a multiyear planning process to allocate resources consistent with the IRS's strategic objectives and Future State Vision. The IT Technology Roadmap, along with enterprise strategic guidance, provides a strong foundation for determining future IT investments to support service delivery improvements. However, IT has to ensure that current production systems continue to execute IRS's core mission of processing tax returns and ensuring taxpayer compliance, securing taxpayer data/systems from cyber threats, implementing new legislative requirements, and maintaining optimal performance, all within a constrained budget. This commitment requires difficult tradeoffs against critical modernization efforts that support the IT Technology Roadmap and unfunded mandates.

To fund the near-term priorities, IT uses the PIP process to capture, review, prioritize, and manage demand for the upcoming fiscal year. The PIP includes validated IT demand for the upcoming fiscal year and estimates for the subsequent year. All demand is categorized by repeatable group, and filing season/internal priority. Information related to the repeatable groups and internal priorities are provided as part of the "References and Artifacts."

Within the Associate Chief Information Officer (ACIO) for Strategy and Planning (S&P), both Financial Management Services (FMS) and Business Planning and Risk Management (BPRM) organizations manage the PIP process through six phases to develop the IT Spend Plan for the Operations Support appropriation. This IT Spend Plan guides spending during Budget Execution and creates the base for the President's Budget Request. The PIP does not include IT major modernization development funded by the Business System Modernization (BSM) appropriation. The Senior Executive Team (SET) and the Digital Subcommittee (DSC) recommends projects for the BSM portfolio.

1.1 Administration

All proposed changes to this document must be submitted in writing, with supporting rationale, to the IRS FMS Plan Development Office.

2 Overview

A **process** is defined as “A set of related **activities** that accomplish a common goal.” The process definition outlined in this document further delineates these activities into **tasks**, each of which have a complete set of attributes defined, such as data and tool specifications along with the role(s) responsible for executing the tasks. Also included are process goals, objectives, metrics, role definitions, policies, and other process related attributes.

2.1 Process Description

2.1.1 The IT Financial Management Services Process

The IRS IT Financial Management process is comprised of Budget Formulation, Plan Development, and Budget Execution, all of which contain a budget monitoring and control activity. These recurring activities normally operate on an annual cycle, driven by the schedules that are external to the IT organization.

The PIP process is part of the Plan Development activity in the IT FMS process. The process provides the structure for collaboration among stakeholders and decision-makers for the budget planning and investment management process. It supports the coordination of enterprise-wide data collection and analysis in support of this process. The process ensures IRS decision-makers have timely, accurate, and consistent information required to enable budget decisions, which are linked to IT investments in support of the IRS’s mission.

2.1.2 The PIP Process

- The PIP process captures all demand associated with IT investments, for two years, and produces an approved IT Spend Plan for the upcoming fiscal year, based on the assumed funding level (including annual enacted appropriation and other funding sources). The PIP process incorporates:
 - Development, Modernization, and Enhancement (DME) demand proposals submitted through the Enterprise Intake (EI) process.
 - Operations and Maintenance (O&M) and legislative requirements submitted through the Project Tracking System (PTS).
 - In addition, after each PIP cycle has concluded, improvements based on lessons learned are incorporated for the next PIP cycle, including updates to priority groupings and internal priority attribute definitions used to classify demand, as necessary.

2.2 Goal

The process goal describes a specific purpose or achievement toward which the efforts of the process are directed. Each process has a specific focus and when combined with the other processes, forms a comprehensive framework for delivering and managing services.

The goal of the PIP process is to identify all demand for the next two years and develop an approved IT Spend Plan for the upcoming fiscal year. The IT Spend Plan aligns available funds with the IT investment priorities.

The six major phases associated with the PIP process are listed below along with the major outputs for each phase (shown in parenthesis):

- Phase 1 – Prepare Planning, Guidance and Communications
- Phase 2 – Collect Demand (Demand Baseline)
- Phase 3 – Validate Demand (Validated Portfolio)
- Phase 4 – Recommend Portfolio (Ratified Portfolio)
- Phase 5 – Implement Portfolio (Execution Strategy and IT Spend Plan)
- Phase 6 - Revise and Rebalance Portfolio

In addition to the six phases, On-Going Support is provided throughout the PIP Process.

2.3 Objectives

Process objectives describe material outcomes that are produced or achieved by the process. The following is a list of process objectives:

- Collect all demand from IT and the Business Operating Divisions (BODs) / Functional Operating Divisions (FODs). The demand includes new and recurring O&M, Key Legislative Programs (KLPs) DME and O&M, and new DME.
- Validate all demand by assessing the operational and business needs, and assign classification attributes (i.e., repeatable groups) and internal priorities to the demand in preparation for leadership reviews.
- Engage with IRS leadership to establish initial funding targets and identify: demand to be funded, demand to execute at risk (in-scope), and demand that is valid but will remain unfunded pending final funding levels (out-of-scope). Communicate the approved IT Spend Plan for the upcoming fiscal year (FY) to all partners within IRS.
- Balance the demand in PTS to the approved IT Spend Plan. Finalize the approved IT Spend Plan for the upcoming fiscal year and upload budget amounts into the Integrated Financial System (IFS) by the due dates specified by the Chief Financial Officer (CFO).
- Review and update the IT Spend Plan as necessary when the IRS receives the enacted budget for the year.
- Update the IT Spend Plan during the Execution Year to account for emerging requirements and other priorities.

2.4 Related Process References and Artifacts

- IT Investment Planning and Management (IPM) Guide
- Enterprise Intake Group (EIG) Process Document
- Repeatable Grouping Definitions
- Priority Classifications Within Each Repeatable Group
- Attribute Definitions for O&M and DME

3 Process Workflow

A process workflow consists of Activities and Tasks, Inputs and Outputs, Roles, and Flow Diagrams. It describes the tasks, procedural steps, organizations or people involved, required input and output information, and tools needed for each step of the process.

3.1 Main Process Diagram

The activities and general timeline for the annual PIP process are depicted in Figure 1.

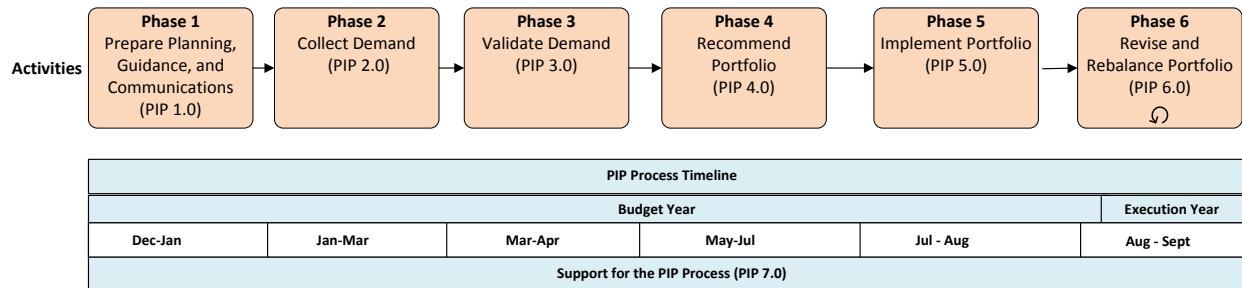


Figure 1. PIP Process

3.2 Inputs

Process inputs are used as triggers to initiate the process and to produce the desired outputs. Users, stakeholders or other processes provide inputs. The following is a list of inputs for this process.

Table 1. PIP Process Inputs

Inputs	Description	Suppliers
Federal Financial Management Policies	Financial Management policies and directives include Office of Management and Budget (OMB) Circular A-11, <i>Preparation, Submission and Execution of the Budget</i> , OMB Circular A-123, <i>Management's Responsibility for Enterprise Risk Management and Internal Control</i> , and the Treasury Federal Information Technology Reform Act (FITARA) - Management's Responsibility for Internal Control, and guidance from the Department of the Treasury on Plan Development.	OMB / Treasury
Capital Planning and Investment Control (CPIC) / Reporting Requirements	Adjustments required by OMB and Treasury on Capital Planning and Investment Control (CPIC) and other reporting requirements must be followed. These may include changes to the reporting schedule and timeline, new/revised investments and data fields.	OMB / Treasury
IRS Strategic Plan	Provides the IRS mission and vision for a given time period, describes the strategic goals and objectives, and highlights trends affecting the IRS.	IRS Commissioner

Inputs	Description	Suppliers
Senior Executive Team (SET) Priorities	Based on the latest IRS Strategic Plan and other oversight guidance, the IRS Commissioner and SET determine the strategic initiatives and priorities developed during the Annual Investment Prioritization Process. The priorities relevant to the planning year are leveraged in the PIP process data collection guidance and data call for new Demand.	SET
Legislative Mandates	Identifies any applicable legislative mandates requiring an IT solution. This information is used to define additional demand for existing system modifications or new IT solutions.	OMB / Treasury
Future State IT Vision and Capability Gaps	Provides the IT Strategy and IT Technology Roadmap required to deliver the Future State vision.	Enterprise Architecture
IT Spend Plan Development Guidance and Assumed Funding Levels	Ongoing guidance and assumed funding levels received throughout the PIP Process. Provides input to the development of planning assumptions and demand adjustments made throughout the process.	IRS CFO / Corporate Budget
Lessons Learned from Prior PIP Process	Improvements based on lessons learned from previous years to the overall process, including updates to priority groupings and internal priority attribute definitions used to classify demand.	FMS Plan Development, Internal / External Stakeholders
Requests for New and Recurring O&M Demand	Requests for IT products and services for Recurring or New O&M in PTS.	Requesters
Requests for O&M and DME Demand for Key Legislative Programs	Requests for IT products and services for O&M and DME for Key Legislative Programs in PTS.	Requesters
Proposals for New DME Demand	Proposals to the IRS IT delivery organization for IT products and services for New DME in HP Project Portfolio Management System (HP-PPM).	Requesters
IT S&P BPA Enterprise Intake Integrated Review Team (IRT) and Enterprise Intake Group (EIG) Reviews	A cross-organizational review and evaluation of Proposals for New DME.	IT S&P Enterprise Intake
FMS Support Services Programmatic and Data Validation Reviews	Review of Recurring O&M, New O&M and DME for Key Legislative Programs plus other selected projects to validate the data associated with the demand requests in PTS.	IT FMS Support Services and Special Programs
ACIO Reviews	Reviews held with ACIOs for their respective area to approve demand for inclusion in the Demand Baseline. ACIO reviews include demand from the BODs / FODs.	ACIOs
IT Leadership Portfolio Reviews	Reviews held with IT leadership to approve the Ratified Portfolio. The output of the reviews may include adjustments to the demand.	IT Leadership
IT FMS Plan Development Data Verification Reviews	Reviews conducted by FMS Plan Development to ensure that the Ratified Portfolio in PTS is aligned to the Execution Strategy and that the IT Spend Plan is uploaded to IFS.	IT FMS Plan Development

Inputs	Description	Suppliers
IRS Leadership Portfolio Reviews	Reviews held with IRS leadership to approve the Execution Strategy for the Ratified Portfolio and the IT Spend Plan. The output of the reviews may include adjustments to the demand.	IRS Leadership
Reporting and Analysis Requests and Requirements	Requests and requirements for reporting and analyzing demand received throughout the PIP process.	Requesters
System Enhancement Requirements	New or revised requirements for PTS and HP-PPM to support the PIP process (based on lessons learned assessment).	Internal and External Stakeholders
Improvements to Decision Analysis and Reporting	Improvements made throughout the PIP process to facilitate better analysis and reporting to the ACIOs, IT and IRS Leadership.	IT and IRS Leadership
Lesson Learned Reviews to Improve Next Cycle	Ongoing reviews to identify improvements to PIP process for the next cycle.	IT FMS Plan Development

3.3 Outputs

Each process produces tangible outputs. These outputs can take the form of products or data and can be delivered to a user or stakeholder, or, they can be used as inputs to other processes. Outputs are measurable in terms of quantity and quality.

Table 2. PIP Process Outputs

Outputs	Description	Recipient
PIP Process Kick-Off Briefings and Guidance Phase 1	Briefing and guidance produced by IT FMS Plan Development and IT S&P Business Planning and Analysis in partnership with DCSE Technology Advisor. Includes an overview of the upcoming PIP process timeline, roles/responsibilities, training and related guidance.	Internal and External Stakeholders, and Requesters
Demand Adjustments from ACIO Review Phase 2	Adjustments to demand identified during ACIO Review sessions.	Requesters
Demand Baseline Phase 2	Demand requests (O&M & KLPs) and EIG DME proposals submitted for funding.	ACIOs, BODs / FODs
Demand Adjustments from Enterprise Intake Group Integrated Review Team (IRT) Reviews Phase 3	Adjustments to demand proposals identified during the Enterprise Intake Group IRT sessions, conducted during Phase 3 – Validate Demand.	Requesters
Demand Adjustments from FMS Programmatic and Data Validation Reviews Phase 3	Adjustments to demand identified during the FMS Programmatic Review sessions, conducted during Phase 3 – Validate Demand.	Requesters

Outputs	Description	Recipient
Validated Portfolio Phase 3	Demand for the upcoming fiscal year that has been reviewed during the Enterprise Intake Group IRT and Programmatic Reviews in Phase 3 – Validate Demand. The Validated Portfolio is a subset of the Demand Baseline (output of Phase 2 – Collect Demand).	IT Leadership
Demand Adjustments from IT Leadership Reviews Phase 4	Adjustments to demand identified during the IT Leadership review sessions in Phase 4 – Recommend Portfolio.	ACIOs, Requesters
Ratified Portfolio Phase 4	Approved in-scope Demand that has been approved for funding by the IT Leadership for the upcoming fiscal year. The Ratified Portfolio is subject to IRS Leadership review, guidance, and funding constraints and changes during the PIP process. The Ratified Portfolio is a subset of the Validated Portfolio (output of Phase 3 – Valid Demand).	IRS Leadership
Execution Strategy for the Ratified Portfolio Phase 5	An analysis and identification of all available funding sources (known and assumed) applied to the Ratified Portfolio. The result is to identify in-scope demand for immediate execution by designating demand items in PTS into one of several funding categories to identify the demand that can be executed with the applicable funding source.	IRS Leadership
Demand Adjustments from FMS Data Verification Reviews Phase 5	Adjustments to demand identified by IT FMS Plan Development to align the Ratified Portfolio with the Execution Strategy and the IT Spend Plan in Phase 5 – Implement Portfolio.	IT Leadership
PIP Phase 5	Demand that is available for funding in the upcoming fiscal year in the Ratified Portfolio. Includes in-scope demand that are the Ratified Portfolio and out-of-scope demand identified in the Validated Portfolio that is considered unfunded due to limited funding availability.	IRS Leadership
IT Spend Plan Phase 5	The IT Spend Plan is a subset of the Ratified Portfolio and is what is uploaded into IFS (actual funds aligned to the demand). IT FMS Budget Execution manages adjustments to the IT Spend Plan during the Execution Year in order to fund in-scope demand in the Ratified Portfolio.	IRS Leadership
IFS Journal Voucher Upload for the IT Spend Plan Phase 5	An export file from PTS that uploads the funded IT Spend Plan into IFS.	CFO

Outputs	Description	Recipient
Demand Adjustments from IRS Leadership Reviews Phase 6	Adjustments to demand identified by/to IRS Leadership to the Ratified Portfolio and the IT Spend in Phase 6 – Revise and Rebalance Portfolio. In addition, IT Leadership adjusts the demand based on revised funding assumptions and priorities.	ACIOs, BODs, FODs
PTS and HP-PPM Demand / Decision Analysis, Reports and Briefings Phases 1-6	Reports, analyses, and briefings produced by IT FMS Plan Development on demand levels.	IT and IRS Leadership, ACIOs, BODs, FODs
Demand System Snapshots Phases 1-6	Historical data in PTS capturing demand data during the PIP process used for analysis and reporting.	IT FMS Plan Management
Lessons Learned Phases 1-6	Knowledge gained throughout the PIP process (positive or negative) derived from actual events or work practices, both internal and external.	Director, FMS

3.4 Activities

An activity is a major unit of work to be completed in achieving the objectives of the process. A process consists of a sequence of related activities that transforms inputs into outputs and is performed by the roles defined in the process. Activities are measurable in terms of efficiency and effectiveness.

Table 3. PIP Process Activity Description

Process ID	Activity Name	Activity Description
PIP 1.0	Phase 1 - Prepare Planning, Guidance, and Communications	<p>Establish the PIP process for the upcoming fiscal year.</p> <ul style="list-style-type: none"> • Develop the PIP process and timeline • Prepare guidance, communication and training materials • Communicate the PIP process and guidance to stakeholders and requesters <p>Primary Outputs:</p> <ul style="list-style-type: none"> • PIP Process Briefings and Guidance • PIP Process Kick-Off Briefings
PIP 2.0	Phase 2 - Collect Demand	<p>Collect demand (nonlabor) for both IT and the BODs and FODs and establish the Demand Baseline.</p> <ul style="list-style-type: none"> • Identify demand for Recurring and New O&M, KLP DME and O&M (new and recurring), and enter in PTS • Identify demand for New DME and enter in HP-PPM • Conduct reviews with ACIOs <p>Primary Outputs:</p> <ul style="list-style-type: none"> • Adjustments to demand as a result of ACIO reviews • Demand Baseline <p>Note: Labor demand is collected in a later phase of the PIP process.</p>
PIP 3.0	Phase 3 - Validate Demand	<p>Validate and adjust, if necessary, all IT operational and BOD/FOD demand captured in the Demand Baseline and establish the Validated Portfolio.</p> <ul style="list-style-type: none"> • Conduct FMS Programmatic and Data Validation Review for Recurring O&M and New O&M, KLP DME and O&M (new and recurring) • Conduct Enterprise Intake IRT reviews for New DME • Inform ACIO and BOD / FOD organizations of adjustments to the demand <p>Primary Outputs:</p> <ul style="list-style-type: none"> • Adjustments to demand as a result of IRT and FMS programmatic reviews • Validated Portfolio

Process ID	Activity Name	Activity Description
PIP 4.0	Phase 4 - Recommend Portfolio	<p>Engage IT Leadership to assess and identify demand to be considered for funding and gain IRS Leadership approval of the result, the Ratified Portfolio.</p> <ul style="list-style-type: none"> • Prepare briefings and discussion materials for IT Leadership Reviews • Conduct IT Leadership Reviews • Develop impact statements for unfunded demand <p>Primary Outputs:</p> <ul style="list-style-type: none"> • Adjustments to demand as a result of IT Leadership reviews • Ratified Portfolio • Impact statements, if any
PIP 5.0	Phase 5 - Implement Portfolio	<p>Develop an Execution Strategy and IT Spend Plan, based on assumed funding levels for the Ratified Portfolio.</p> <ul style="list-style-type: none"> • Identify demand to be executed at risk (in-scope and out-of-scope) • Prepare, review, and approve the Execution Strategy • Conduct FMS Data Verification Reviews • Balance PTS to the Approved IT Spend Plan • Implement the IT Spend Plan in IFS <p>Primary Outputs:</p> <ul style="list-style-type: none"> • IT Spend Plan and Execution Strategy to include in-scope and out of scope (funded/unfunded) • Adjustments to demand as a result of FMS data verification reviews • IFS IT Budget uploaded based on assumed funding levels (pending an enacted budget)
PIP 6.0	Phase 6 - Revise and Rebalance Portfolio	<p>Review with and gain endorsement from IRS Leadership to the PIP. Rebalance the Ratified Portfolio throughout the execution year.</p> <ul style="list-style-type: none"> • Prepare and conduct briefings to IRS Leadership • Communicate changes to the IT Spend Plan to all partners • Revise and rebalance Ratified Portfolio to reflect changes in funding and priorities. Note: In addition, IT Leadership adjusts the demand based on revised funding assumptions and priorities. <p>Primary Outputs:</p> <ul style="list-style-type: none"> • Adjustments to demand as a result of IRS Leadership Reviews • IT Spend Plan adjustments captured in PTS and balanced

Process ID	Activity Name	Activity Description
PIP 7.0	Provide Ongoing Support for the PIP Process	<p>Provide ongoing operational support for the PIP process.</p> <ul style="list-style-type: none"> • Manage the implementation of the PIP process and system requirements • Develop reports and conduct analysis of the demand • Identify and document lessons learned <p>Primary Outputs:</p> <ul style="list-style-type: none"> • Demand and decision analysis, reports, and briefings • Snapshots of demand, also referred to as "data sets" • Document lessons learned

3.5 Roles

Each process defines at least one role. Each role is assigned to perform specific tasks within the process. The responsibilities of a role are confined to the specific process. They do not imply any functional standing within the hierarchy of an organization.

Table 4. PIP Roles

Name	Description
IT FMS Plan Development Team	<p>Manage the PIP process by providing guidance and support to partners throughout the process.</p> <ul style="list-style-type: none"> • Provide consolidated submission of the demand from the Enterprise Intake Process and PTS for use throughout the PIP process • Analyze assigned projects and provide program managers and IT/IRS Leadership information on financial trending • Support program reviews and leadership meetings with analysis and presentation material that facilitates discussion of issues and possible resolution • Manage the funded and unfunded demand in PTS during the PIP process
IT S&P Business Planning & Analysis Team	<p>Lead Phase 2 – Collect demand for all New DME and Treasury Executive Office for Asset Forfeiture (TEOAF) DME proposals that should be submitted in the HP-PPM system through the EI Process.</p> <ul style="list-style-type: none"> • Conduct Enterprise Intake IRT or EIG Data Validation Reviews for proposals for New DME • Provide IT FMS Plan Development with a report of all demand collected through the Enterprise Intake Process for the requested period • Manage HP-PPM system used to process proposals for New DME

Name	Description
IT FMS Support Services Team	<p>Prepare detailed data collection guidance for each ACIO area. Manage data collection process for KLPs, Recurring and New O&M demand and enter in PTS.</p> <ul style="list-style-type: none"> Analyze demand and participate in Programmatic and Data validation review sessions. Review data to ensure compliance with policy and strategic guidance Make adjustments to demand in PTS resulting from reviews in Phase 4 - Recommend Portfolio, Phase 5 – Implement Portfolio, and Phase 6 – Revise and Rebalance Portfolio Ensure ACIOs understand/concur with adjustments to the demand Prepare reports and conduct analysis of the demand
IT FMS Special Programs Team	<p>Manage data collection process for Recurring and New O&M demand for selection Key Legislative Programs.</p> <ul style="list-style-type: none"> Analyze demand and participate in Programmatic and Data validation sessions for KLPs and review data to ensure compliance with policy and strategic guidance Make adjustments to the demand in PTS resulting from PIP process reviews in Phase 4 – Recommend Portfolio, Phase 5 – Implement Portfolio, and Phase 6 – Revise and Rebalance Portfolio Ensure ACIOs understand/concur with adjustments to the demand Prepare reports and analysis of the demand
Requester	<p>Identify request for demand or proposals for IT products and services.</p> <ul style="list-style-type: none"> Create requests for demand or proposals for New DME in HP-PPM, for Recurring or New O&M or KLP DME in PTS during Phase 2 – Collect Demand Ensure request has received BOD / FOD head-of-office approval Analyze funding needs and prepare justifications and estimates to support requested demand and proposals Present requested demand to the IRT; answer questions; take necessary follow-up actions Analyze adjustments to demand received during reviews <p>Requesters include IT Program Managers, BOD / FOD business systems partners, and other IT staff.</p>
ACIO	<p>Review, direct adjustments and approve demand for inclusion in the Demand Baseline. Participate in IT leadership reviews conducted in Phase 4. Implement adjustments based on IT and IRS Leadership reviews.</p> <ul style="list-style-type: none"> Review and approve requests for demand or proposals received during Phase 2 – Collect Demand Support Enterprise Intake Group IRT reviews to validate demand and review adjustments to demand identified in Phase 3 – Validate Demand Participate in the IT Leadership reviews to establish the Ratified Portfolio Direct adjustments to demand resulting from IT and IRS Leadership Reviews
DCSE Technical Advisors	<p>Serves as a liaison between IT and the BODS and FODs during the PIP process. Clarifies guidance, coordinates review actions, and assist with communication throughout the process.</p>

Name	Description
IT Leadership Team	<p>Review and approve the Ratified Portfolio, which may include adjustments to the demand resulting from IRS Leadership reviews.</p> <ul style="list-style-type: none"> Review the Validated Portfolio produced during Phase 3 – Validate Demand, and gain consensus on adjustments to the demand required to establish the Ratified Portfolio in Phase 4 – Recommended Portfolio Communicate the Execution Strategy developed in Phase 5 – Implement Portfolio, to ACIOs and BODs / FODs Receive guidance and adjustments to the demand from IRS Leadership and Director, FMS in Phase 6 – Revise and Rebalance Portfolio Communicate adjustments to the demand in the Ratified Portfolio to ACIOs to reflect IRS Leadership guidance <p>Senior Leadership within the IRS IT organization includes the Chief Information Officer, Deputy CIO, Operations, Deputy CIO, Strategy/ Modernization and ACIOs for Strategy & Planning, Applications Development, User & Network Services, Enterprise Operations, Enterprise Services, Enterprise Program Management Office, and Cybersecurity.</p>
IRS Leadership Team	<p>Review the Ratified Portfolio and issue guidance to the Director, FMS, and IT Leadership on needed adjustments.</p> <ul style="list-style-type: none"> Review the Ratified Portfolio and recommended Execution Strategy Assess spending levels, supply and demand funding gaps and risk levels Endorse the Ratified Portfolio At their discretion, share the Ratified Portfolio with the Senior Executive Team (SET) <p>The IRS Leadership Team consists of the CFO, CIO, Deputy Commissioner of Operations Support (DCOS) and Deputy Commissioner of Services and Enforcement (DCSE)</p>
Director, IT FMS	<p>Provide executive leadership, direction, and policy pertaining to Budget and Financial Policy across IT throughout the PIP process, and lead budget briefings with IRS Leadership.</p> <ul style="list-style-type: none"> Lead the preparation of briefings and analysis on the Ratified Portfolio and Execution Strategy with IRS Leadership Review Ratified Portfolio and Execution Strategy with IRS Leadership in Phase 6 – Revise and Rebalance Portfolio Analyze demand adjustment guidance from IRS Leadership and formulate necessary demand adjustments to the Ratified Portfolio Communicate needed demand adjustments to IT Leadership and oversee compliance during the Budget Execution
IT FMS Budget Execution Team	<p>Manage the IT Spend Plan during Budget Execution, including certification, funding, transfers, analyses, and reporting.</p> <ul style="list-style-type: none"> Prepare briefings and analysis on the Ratified Portfolio for IT and IRS Leadership during Budget Execution in Phase 6 – Revise and Rebalance Portfolio Prepare communications from IRS/IT Leadership on adjustments to the demand Identify changes to the Ratified Portfolio in PTS during budget execution Manage updates to the IT Spend Plan during Budget Execution Maintain contact with CFO Budget staff on funding sources

4 Process Control

Activities involved in ensuring a process is predictable, stable, and consistently operating at the target level of performance.

4.1 Controls

Process controls represent the policies and guiding principles on how the process will operate. Controls provide direction over the operation of processes and define constraints or boundaries within which the process must operate. Table 5 identifies and describes process controls for the PIP process.

Table 5. PIP Process Controls

Name	Description
Change Management Policies	Policies and procedures that identify and manage changes to the process.
Management Reports	Reports that indicate the state, progress, and adherence to schedules and procedures of the ongoing process.
Policies	Principles that guide decision-making and operations of the process.
Process Measurement Plan	Plan that identifies and describes metrics and the process used to conduct periodic assessment of the process.
Security Policies	Policies governing access and changes to systems containing financial and/or budget data including PTS, IFS, HP-PPM, and Work Request Management System (WRMS).

4.2 Metrics

Metrics are used to periodically assess and measure process success in quantitative terms. They should be associated with targets that are set based on specific business objectives. Metrics provide information related to the process goals and objectives and are used to take corrective action when desired results are not being achieved. Metrics can also be used to drive continual improvement of process effectiveness and efficiency.

Management will regularly set targets for process performance, gather quantifiable data related to different functions of the PIP process, and review that data in order to make informed decisions and take appropriate corrective action, if necessary. All measurements will have a defined data dictionary, map to the organizational strategic goals, and be documented in a Process Measurement Plan. The Process Measurement Plan template is available in the IT Process Asset Library (IT PAL).

4.3 Policies

Policies outline a set of plans or courses of action that are intended to influence and determine process decisions or actions. Policies provide an element of governance over the process that provides alignment to business vision, mission, and goals.

Process Management

People

Statement:

Roles and responsibilities for the process must be clearly defined and appropriately staffed with people having the required skills and training. The mission, goals, scope, and importance of the process must be clearly and regularly communicated by upper management to the staff and business customers of IT. All IT staff (direct and indirect users of the process) shall be trained at the appropriate level to enable them to support the process.

Rationale:

It is imperative that people working in, supporting or interacting with the process in any manner understand what they are supposed to do. Without that understanding, the PIP process will not be successful.

Process

Statement:

Modifications to the PIP process must be approved by the Process Owner. Process design must include appropriate interfaces with other processes to facilitate data sharing, escalation and workflow. The process must be capable of providing data to support real-time requirements as well as historical/trending data for overall process improvement initiatives. The process must be fully documented, published, and accessible to the various stakeholders of the process. The process will be reviewed periodically in order to ensure it continues to support organizational goals and objectives (continuous improvement). The process must include Inputs, Outputs, Controls, Metrics, Activities, Tasks, Roles and Responsibilities, and Tool and Data requirements, along with documented process flows. The process will be kept straightforward, rational, and easy to understand.

Rationale:

The process must meet operational and business requirements.

Technology and Tools

Statement:

All tools selected must conform to the enterprise architectural standards and direction. Existing in-house tools and technology will be used wherever possible, and new tools will only be considered if they satisfy a business need that cannot be met by current in-house tools. The selection of supporting tools must be process driven and based on business requirements. Selected tools must provide ease of deployment, customization, and use. The selected tools must support heterogeneous platforms. Automated workflow, notification, and escalation will be deployed wherever possible to minimize delays, ensure consistency, reduce manual intervention, and ensure appropriate parties are made aware of issues requiring their attention.

Process tools include:

- HP-PPM IFS
- PTS
- WRMS

Rationale:

Technology and tools should be used to augment the process capabilities, not become an end themselves.

4.4 Tailoring Guidelines

The tailoring guidelines identify the allowable variations of the IT organization's standard process as needed for adjustments (adding, deleting, modifying) relative to specific operational or functional needs of another organization. Process tailoring is about roles and procedures, not the standard process or major activities defined in this process. All tailoring requests, with supporting rationale, must be submitted in writing to and approved by the PIP process owner.

5 Training

Process training involves training all stakeholders about key processes that are crucial for an organization to deliver business objectives. Training provides clarity to employees on a set of procedures that need to be carried out as part of the process and the best possible way to do them. Listed below are the training resources available for this process:

- IT FMS Plan Development Kick-Off Meeting provides requesters and process stakeholders with guidance for the upcoming PIP Process and identifies any changes
- IT FMS Plan Development Process Training provides participants and stakeholders with training on the process to ensure understanding of the activities, tasks, timelines, roles and responsibilities and tools used during the PIP Process
- IT S&P BPA New DME Training Materials provide training to requesters on how to develop and submit DME Demand requests in HP-PPM

6 Appendix

6.1 Acronyms

Acronyms	Definition
ABLE	Achieving a Better Life Experience
ACA	Affordable Care Act
ACIO	Associate Chief Information Officer
BOD	Business Operating Division
BPA	Business Planning & Analysis
BSP	Business Systems Planning
CFO	Chief Financial Officer
CIO	Chief Information Officer
CPIC	Capital Planning and Investment Control
DCIO	Deputy Chief Information Officer
DME	Development, Modernization, and Enhancement
FATCA	Foreign Account Tax Compliance Act
FMS	IT Financial Management Services
FOD	Functional Operating Division
FY	Fiscal Year
HCTC	Health Coverage Tax Credit
HP-PPM	HP Project Portfolio Management System
IFS	Integrated Financial System
IRS	Internal Revenue Service
IRT	Integrated Review Team
IT	Information Technology
IT PAL	IT Process Asset Library
KLP	Key Legislative Program
O&M	Operation and Maintenance
OMB	Office of Management and Budget
PDC	Private Debt Collection
PIP	Portfolio Investment Plan
PTS	Project Tracking System
S&P	Strategy and Planning
SET	Senior Executive Team
TEOAF	Treasury Executive Office for Asset Forfeiture
WRMS	Work Request Management System

6.2 Glossary

Term	Definition
ACIO	ACIOs include: IT Strategy & Planning, Applications Development, User & Network Services, Enterprise Operations, Enterprise Services, Enterprise Program Management Office, and Cybersecurity.
BOD / FOD	Organizations external to IT that are responsible for submitting their business needs for IT Services. For demand submitted through Enterprise Intake, the business owners are the senior-level executives within the applicable area of IRS responsible for providing executive sponsorship of the investment.
Budget Year (or Upcoming Fiscal Year)	The fiscal year for which the budget is being considered. It is the current fiscal year + 1 (identified in OMB A-11, Preparation, Submission, and Execution of the Budget as the "Current Year").
Demand	Demand referenced in this document is all IT demand.
Demand Baseline (Phase II)	All Demand requests- (O&M & KLPs) and proposals (DME) submitted for funding.
Enterprise Intake Process	Process used to collect and manage new demand requests for IT products and services.
Execution Strategy Ratified Portfolio (Phase V)	An analysis of the available funding sources against the Ratified Portfolio in order to identify in-scope and out-of-scope demand and apply the designated funding categories in PTS.
Execution Year	The fiscal year preceding the budget year under consideration (identified in OMB Circular A-11, <i>Preparation, Submission, and Execution of the Budget</i> , as the "Execution Year").
FMS Programmatic and Data Validation Review	Review and validate Recurring O&M, New O&M and DME for Key Legislative Programs and other selected projects. IT FMS Plan Development leads the programmatic reviews of selected projects. IT FMS Support Services leads the review on all other demand.
Fund Category Codes	<p>In-Scope (Refer to Definition)</p> <p>Generally, IT does not have sufficient resources to fund all demand and assigns funding codes to facilitate transparency into the demand during the execution year. Below are some of the common codes used during plan development. Fund category codes are added/deleted based on reporting requirements throughout the execution year.</p> <p><u>FundedR</u> - Corporate Risk for approved demand pending funding. <u>FundedU</u> - Approved demand pending user fees.</p> <p>In Scope also includes any demand assigned to a valid appropriation code (i.e., ****0919D, ****09A9D, ****09E9D, ****0921D).</p> <p>Out-of-Scope (Refer to Definition)</p> <p><u>UnfundedX</u> - Valid demand not approved for funding.</p> <p><u>UnfundedD</u> – Unfunded deferred demand where Leadership made a decision to defer this amount from funding consideration. This is a valid demand viewed as “nice to have,” but not a priority and operationally there is nothing foreseen that would require reconsideration/funding in the execution year.</p> <p><u>UnfundedP</u> - This is used for reductions taken as risk during the PIP. This is valid demand and there is a potential for direct operational driver(s) that could require reconsideration/funding during execution.</p>

Term	Definition
HP-PPM	Commercial-Off-the-Shelf (COTS) software package that is used to register and manage demand for IT products and services and investment funding requests through two separate modules: Proposal Demand Management Module and Work Request Demand Management Module.
IFS Journal Voucher (JV)	Form used to process accounting entries in IFS. Primarily used for fund transfers and corrections.
In-Scope Demand	Demand approved for funding by the IT Leadership in the upcoming fiscal year.
Internal Stakeholder	Organizational entities directly involved in designing and managing the PIP process. Internal stakeholders include IT FMS organizational entities, IT S&P BPA, and PTS and HP-PPM system support groups.
IRS Leadership	Consists of the Commissioner and the Senior Executive Team (SET)
IRT Review	Provides a cross-organization review and evaluation of submitted DME and associated O&M demand.
Demand Funding Sources	Sources of funds for executing IT demand. Examples include current year appropriations, 50% carryover, no-year funds, inter-appropriation transfers, and user fees. Not all sources are available at the start of the fiscal year.
Demand Proposals	Demand Proposal to the IRS IT delivery organization for IT products and services for new DME (refer to definition), including TEOAF.
Demand Requests	Demand Requests submitted to the IRS IT delivery organization for IT products and services for Recurring or new O&M, and O&M and DME for Key Legislative Programs.
IT Financial Management Services (FMS)	Organization within the Strategy and Planning ACIO area that provides executive leadership, direction, and policy in all matters pertaining to the IT Budget.
IT FMS Budget Execution	Organization within FMS that administers the Ratified Portfolio to support the delivery of IT products and services to its customers and stakeholders. Budget Execution capabilities enable tactical executive decision-making by managing current year activities.
IT FMS Budget Execution Program and Policy Group	Organization within IT FMS Budget Execution responsible for administering the technology support for PTS including managing the Sustaining Infrastructure and Infrastructure Currency Programs.
IT FMS Budget Formulation	Organization within FMS which transforms multi-year strategic planning projections into a structured, budget request submitted to Congress. Budget Formulation activities represent the investments the IRS needs to make to implement the Future State Vision.
IT FMS Budget Formulation Plan Development Group	Organization within FMS Budget Formulation that completes all formulation and plan development activities. Organizes and carries out annual and multi-year budgeting for IT. Efficiently and effectively links and implements funding sources with demand by analyzing data, mapping workflows, and scheduling change accommodations.
IT FMS Budget Formulation Special Programs Group	Organization within FMS Budget Formulation which manages demand for the Business Systems Modernization appropriation and the ACA Key Legislative Program.
IT FMS Support Services	Organization within FMS which oversees finance operations for assigned IT organizations enhancing the ability to meet the IRS's business requirements through the execution of innovative financial solutions consistent with organizational goals and priorities. Support Services Groups work with ACIOs in execution year to process requisitions.
IT Leadership	Senior leadership within the IRS IT organization includes the Chief Information Officer, Deputy CIO, Operations, Deputy CIO, Strategy/ Modernization, and ACIOs for Strategy & Planning, Applications Development, User & Network Services, Enterprise Operations, Enterprise Services, Enterprise Program Management Office, and Cybersecurity.

Term	Definition
IT Program Manager	Monitors and controls the expenditure of funds and ensures that the project delivers as expected, in accordance with the approved cost, schedule, and performance baseline as documented in the approved baseline. Responsible for the development of all project management documentation and artifacts (e.g., business case, work breakdown, and resource breakdown structure) to support monitoring activities.
IT S&P Business Planning & Analysis	Organization within the Strategy and Planning ACIO area which partners with IRS executives and external stakeholders to enable selection, planning, and management of an IT investment portfolio that aligns with IRS strategic priorities.
IT Spend Plan Phase V	The IT Spend Plan is a subset of the ratified portfolio that has been uploaded into IFS.
IT Strategy and Planning	The ACIO area which provides strategic and financial leadership to achieve responsible planning, execution and stewardship of information technology.
Key Legislative Programs	Examples of Key Legislative Programs are ACA, ABLE, HCTC, FATCA, and Private Debt Collection (PDC).
New DME	Above Core funding requests for new/continuing or enhanced IT functionality to IRS systems, or to purchase commodities (i.e., software, licenses, telecom, hardware, contractor installation services). Includes all new or continuing DME not associated with KLPs, and PDC. Also includes changes / modifications to existing systems to improve capability or performance.
New O&M	Maintenance or service increases due to a prior year approved DME project deployment or sustaining infrastructure purchase.
Out-of-Scope Demand Phase V	Demand that has not been approved for funding
Portfolio Investment Plan (PIP) Process	The process used to develop the PIP and the IT Spend Plan for the upcoming fiscal year. It refines the formulated budget into an IT Spend Plan that meets the IRS strategic vision while remaining in alignment with assumed funding levels. The IT Spend Plan identifies how IT will execute approved funding during the upcoming fiscal year.
Project Tracking System (PTS)	A web-based software application that provides a standardized, automated method of budget management across a diverse group of organizations, activities, and Spend Plan Items. PTS provides exporting of Excel reports and full reporting through Business Objects. PTS is owned, sponsored, and managed by IRS IT Financial Management Services.
Ratified Portfolio	Demand in PTS that has been approved by the IT Leadership in the upcoming fiscal year.
Recurring O&M	Demand to maintain at current capability and performance levels, filing season legislative directives, and "rust replacement."
Senior Executive Team (SET)	The Commissioner, the Deputy Commissioner of Operations Support (DCOS), the Deputy Commissioner of Services and Enforcement (DCSE), and all direct-report Executives to those three positions. Establishes the strategic priorities to which investment proposals must align in order to merit consideration, and develops priorities on an annual basis.
Unfunded Demand	Demand in the Validated Portfolio that is considered valid but is unfunded due to funding limitations and cannot be executed. Unfunded demand is Out-of-Scope.
Upcoming Fiscal Year	The fiscal year that is the focus of the PIP process. It is the prospective fiscal year, or the Budget Year (current fiscal year plus one).
Validated Portfolio	Demand in the Validated Portfolio for the upcoming FY that has been reviewed during the Enterprise Intake Group IRT and Programmatic Reviews during Phase 3, Validate Demand.

**QUESTIONS FOR THE RECORD
HEARING BEFORE THE COMMITTEE ON WAYS AND MEANS
OVERSIGHT SUBCOMMITTEE
UPDATE ON IRS AND DOJ EFFORTS TO RETURN SEIZED FUNDS TO
TAXPAYERS
JUNE 20, 2018**

Questions from Chairman Jenkins.

- 1. Would the Internal Revenue Service (IRS)'s Criminal Investigation (CI) agents be involved in multi-agency crime task forces to combat drugs, money laundering, financial crimes, and terrorism?**

Answer: Yes. IRS CI special agents are experts in following the money trail and participate in a variety of multi-agency investigations, financial task forces and narcotics task forces. Some of these task forces include Organized Crime Drug Enforcement Task Force (OCDETF), High Intensity Drug Trafficking Area (HIDTA), Joint Terrorism Task Force (JTTF), Financial Crimes Task Force (FCTF), Suspicious Activity Review Task Force (SAR-TF), National Cyber Investigative Joint Task Force (NCIJTF) and the National Cyber Forensics and Training Alliance (NCFTA).

- a. On those task forces, would the CI agents be aware of crimes other than tax fraud?**

Answer: In most investigations, IRS-CI leads the investigative efforts into potential tax and financial crimes (money laundering and Bank Secrecy Act violations) while our partner agencies lead efforts into other crimes. However, since the other crimes being investigated are usually the specified unlawful activity that produced the illicit monies being laundered, it is critical that IRS-CI be aware of and understand other violations being investigated.

- 2. In general, is there a potential for a case to show indicia of tax fraud from an IRS seizure that IRS was unaware of?**

Answer: Yes. IRS may initially be involved in a money laundering or Bank Secrecy Act investigation that results in a seizure of criminal proceeds. During the non-tax investigation the IRS may later uncover indicia of tax fraud and expand to include potential tax changes.

Question from Representative Bishop.

For the 256 petitions referred to the U.S. Department of Justice for review, under current IRS policy, would the IRS have still made the majority of these seizures today?

Answer: While each case is dependent on its own set of facts, if the only evidence supporting the seizure was a violation of Title 31 structuring and the source of the structured funds was tied to a legal source, the IRS would likely not have seized those funds.

Buchanan:

- 1. In the Internal Revenue Service's (IRS) oral testimony, IRS witnesses referenced the "Digital Roadmap" as a component of the IRS Technology Roadmap.**

a. Please explain the relationship between these two documents.

The Technology Roadmap and Digital Roadmap were initially created separately and evolved with distinct communication needs. The Technology Roadmap, developed and maintained by the IRS Enterprise Architecture (EA) office, is a broad, long-range view of the IRS IT direction originally published in January 2015. It is intended to "translate" the future state business vision into needed IT capabilities and services, and guide investment planning and architecture development. The IRS Technology Roadmap describes a vision for harnessing modern technology paradigms (e.g., Service Oriented Architecture, Application Program Interfaces, Analytics, DevOps, Cloud) to enable key business priorities, such as the move toward online taxpayer accounts and on-arrival tax processing. The Technology Roadmap also identifies the envisioned architecture and plans for ensuring the security of IRS data and information assets. The Technology Roadmap is used to facilitate a conversation between IRS business and IT leaders around the future direction, priorities, and alignment of investments and resources to achieve a common vision.

The Digital Roadmap was initially created in early 2015 as a crosswalk document between the Technology Roadmap and six (6) key initiatives that were identified by the Digital Subcommittee. The Digital Subcommittee is comprised of the two IRS Deputy Commissioners, Wage and Investment Division Commissioner, Small Business/Self-Employed Division Commissioner, Chief Information Officer and Director, Online Services, and plays a critical role in governance and oversight of the digital initiatives. The Digital Roadmap was effectively a realization of the IRS Digital Strategy. Today, the Digital Roadmap is shown as a subset of Digital Strategies which are aligned within the overall Technology Roadmap. The original crosswalk document is now maintained as a summary of the Digital Strategies, with implication and cross linking maintained within the Technology Roadmap. The Digital Strategies represent IRS's prioritized set of digital and modernization initiatives or programs that enable the digital taxpayer experience (e.g., Online Account, Authentication, Authorization, IRS.gov, Taxpayer Digital Communication (TDC) solutions, third party services). The Digital Strategies provide greater detail into the specific projects and plans in the priority areas. As the vision and plans evolve under the direction of the Digital Subcommittee, the Technology Roadmap is updated as appropriate.

b. How often are the IRS Technology Roadmap and Digital Roadmap updated?

The Technology Roadmap is planned for an updated release (i.e., new content, significant updates) 3-4 times per year, with any additional "maintenance" releases as needed (i.e., in the case of minor but important changes to the IRS business or

technology direction, or identification of errors needing correction). Changes to the Technology Roadmap are periodically (usually annually) reviewed by executives of IT/Enterprise Services (ES) and major changes are reviewed by CIO. The Digital Subcommittee reviews and monitors progress to the Digital Strategies and resultant changes are maintained and updated with concurrence from the Digital Subcommittee.

c. Please describe the process for proposing changes needed to one or both of these documents and the process for approving such changes.

The Enterprise Architecture (EA) office within IRS IT is responsible for developing and maintaining the IRS Technology Roadmap. The EA team continuously assesses the IRS business and technology landscape and plans (e.g., strategic planning documentation, program/project plans, and investment information) as inputs and proactively identifies and validates needed changes. In addition, the roadmap is available online for all IRS employees with access to the intranet, and anyone may contact the EA team with proposed changes, which the EA team evaluates, prioritizes and incorporates as appropriate. Finally, the Technology Roadmap is regularly socialized through briefings, and these sessions provide a forum for stakeholders to provide feedback. For the Digital Strategic Initiatives, the Digital Subcommittee periodically reviews the business and IT landscape (e.g., strategy and operational plans, the Technology Roadmap, architecture plans, investment proposals) and identifies any required changes to the Digital Strategic Initiatives (e.g., capabilities, funding posture, timelines), which is maintained by the office of Online Services (OLS) and IT Enterprise Services (IT/ES). The Digital Strategic Initiatives are frequently socialized with key IRS stakeholders, and feedback obtained is reviewed and approved by the subcommittee. Changes are then evaluated by the IRS EA team and reflected within the IRS Technology Roadmap.

d. Please provide a list of the individuals who must approve changes made to these documents.

The development of the Technology Roadmap is led by the EA office within the IT division, and the EA Director approves each new release/update. In addition, for major changes and releases changes, it is reviewed and approved by the Associate CIO for Enterprise Services and the CIO. The Digital Strategic Initiatives are approved by the Digital Subcommittee of the Services and Enforcement Executive Steering Committee (ESC).

e. How does the IRS measure the usefulness of these documents?

The IRS continuously assesses the usefulness of the Technology Roadmap qualitatively through conversation and collaboration with stakeholders across the enterprise. The IRS EA office team defines usefulness for the Technology Roadmap on several dimensions: (1) quality and accuracy of information in reflecting a long-range vision and plans for IRS IT, in alignment with the enterprise business direction; (2) ability for readers to

understand and apply the information; (3) support for evaluation of IT investments and priority setting; and (4) informing program/project solution architectures (i.e., providing a broader framework of technology direction into which those solutions must fit).

Through a continuous socialization process and feedback loop, IRS EA has consistently evolved the Technology Roadmap with new views and content, refinements, and improvements to usability. The usefulness of the Technology Roadmap and the Digital Strategies is measured by actual program deliverables, e.g. WebApps, IRS.gov, third party services, and other programs that are delivering capabilities into production. In addition, the Technology Roadmap helps stakeholders understand how IT investment priorities impact delivery of the future state capabilities.

2. In Fiscal Year (FY) 2016, the IRS spent \$800 million on modernization efforts. Please explain how this money was spent and what additional functionality or progress was achieved in FY 2016 using these funds.

In FY 2016, the IRS spent \$789 million on development, modernization and enhancements (DME) across the IT enterprise. Significant development addressed major areas such as support to taxpayers, compliance and enforcement, identity theft/ refund fraud/ cyber and other security, legislative mandates and operational upgrades. The following are key new functionalities and/or progress for each area.

Support to Taxpayers:

- Launched website to support the voluntary registration of Certified Professional Employer Organizations (CPEO) and 501(c)(4) organizations, mandated by Congress in the Tax Increase Prevention Act of 2014.
- Deployed a new telephone delivery system in 4 of 33 planned taxpayer contact center call sites that is enabling better service to taxpayers. This replacement of legacy automated call distributors used to route taxpayers on the call center platform improves security and stability, increasing customer satisfaction with new call center agent functionality.
- Deployed penalty and interest adjusted refundable credit capabilities that correct 8 million tax modules with inaccurate failure to pay penalty computations for adjusted refundable credits.
- Improved accuracy of financial reports by including pending payment transactions in the unpaid assessment balance.
- Implemented financial/utility verification and two-factor authentication for the web applications Get Transcript and IPPIN (Identity Protection PIN).

Compliance and Enforcement:

- Deployed the International Compliance Management Model (ICMM) Cryptography update, increasing the security of all incoming and outgoing Foreign Account Tax Compliance Act data.

- Deployed multiple Financial Institution Registration maintenance releases improving the user experience for all Foreign Financial Institution users as well as Host Country Tax Authorities.
- Developed the Withholding and Refund project, which establishes streamlined methods to conduct compliance activities; compares forms filed by the withholding agent with forms filed by the recipient and deposit information from the withholding agent; and uses that information to allow or deny the credits claimed by taxpayers.

Identity Theft/ Refund Fraud/Cyber and Other Security:

- Sponsored the first Bureau-led Cybersecurity Community of Practice forum to enhance information sharing of Cybersecurity best practices. The interest garnered from this meeting has led to two additional forums sponsored subsequently by the Mint and the Alcohol and Tobacco Tax and Trade Bureau (TTB).
- Implemented network protection capability that blocked transmission of over 16,000 un-encrypted emails from leaving the IRS network, preventing the possible disclosure of sensitive data such as social security numbers and passwords.
- Implemented two cybersecurity threat countermeasures to prevent malware being installed on .gov networks and facilitate malicious email filtering. IT detected and mitigated phishing and malware sites, and conducted a phishing pilot to train employees to properly identify and react to this threat.
- Implemented software capability and process to track contractor security training completion/timeliness relative to eligibility for IRS system access. With this capability, IRS can quickly disable the account of any contractor who fails to complete minimum security awareness training.
- Deployed Unified Network Access Phase One to five Initial Operating Capability (IOC) sites, allowing IRS to view network connections and ensuring only authorized users and devices can connect to the IRS network.
- Expanded the Integrated Enterprise Portal (IEP) environment security protections and tools that significantly improved the detection and remediation of attempted external attacks aimed at IRS.gov via automated scripts, bots, and suspicious and malicious Internet Protocol addresses. The layered security tools protect taxpayer facing applications at the earliest entry point of the IRS infrastructure, which is the edge security and portal environment.
- Implemented advanced analytics and fraud detection capabilities within the IRS IEP and eAuthentication environments to better protect access to the Get Transcript application.
- Enhanced monitoring and analytic capabilities through investments in infrastructure, tools, and development expertise to accelerate continuous data monitoring.

Legislative Mandates:

- Developed the Affordable Care Act Information Returns (AIR) system, which processed over 200 million Forms 1095-B and over 100 million Forms 1095-C between January 20, 2016, and September 3, 2016. These forms provide information to the IRS from health care coverage providers on individuals with minimum essential coverage (as defined by law), and allow the IRS to determine whether employers are offering health insurance coverage to their full-time employees, and , if so, information about the coverage offered.
- Implemented the modification to the Health Coverage Tax Credit (HCTC). Previously, those eligible for the HCTC could claim the credit based on premiums they paid for certain health insurance coverage through 2013. This change allowed claims for coverage through 2019.
- Implemented the Achieving a Better Life Experience (ABLE) Act, which was included in the Tax Increase Prevention Act of 2014 (Public Law 113-295) and included two components impacting the IRS. The first component enacted new Section 529A of the Internal Revenue Code of 1986 to create tax-free savings accounts for individuals with disabilities to cover qualified disability expenses such as education, housing and transportation. The second component established a Certified Professional Employer Organization (CPEO) certification program that provides authority for CPEOs to collect and remit federal employment taxes under a CPEO Employer Identification Number for wages paid to individuals covered by a service contract.
- Implemented capabilities related to the Foreign Account Tax Compliance Act (FATCA) to improve tax compliance for U.S. taxpayers holding financial accounts at Foreign Financial Institutions (FFIs) and to promote and facilitate international tax information sharing. FATCA requires certain FFIs with U.S. accounts to register with the IRS, report U.S. accounts annually to the IRS, and withhold 30 percent of selected U.S. source payments made to recalcitrant account holders and nonparticipating FFIs. FFIs that do not comply with their obligations are subject to 30 percent withholding on certain U.S. source payments. The FATCA program updated existing and prior year FATCA forms (paper and electronic). These form changes include Modernized E-File (MeF) updates to Form 1042-S data including updates to Business Objects reporting, Withholding and Refund Credit Freeze changes for Forms 1040NR and 1120-F filings, and processing and storage of existing and prior year FATCA forms in the International Compliance Management Model (ICMM) system. Additional capabilities included the reciprocal exchange with certain jurisdictions of information on payments to accounts at U.S. financial institutions held by residents of such jurisdictions.

Operational Upgrades:

- Reduced operations and support costs for over 10,000 servers with successful implementation of new Server Administration strategy, with increased number of servers managed by a single Systems Administrator to 258—a 342% increase over 2015.
- Upgraded the IBM Enterprise Server and achieved new efficiencies in data encryption resulting in enhanced security of taxpayer data and improved processing performance.

- Began the multi-year effort related to eRecords Management (Microsoft Strategic Initiatives-Enterprise Exchange/SharePoint upgrade), to provide an enterprise solution that will upgrade the information technology infrastructure with foundational electronic records management capabilities which will store, preserve, and retire email records, and which will allow the IRS to meet federal records management mandates.
- a. The IRS information technology (IT) Development, Modernization, and Enhancement budget is expected to decline from 30 percent of total IT spending in FY 2016 to 14 percent in FY 2018, while the total IT budget is expected to remain relatively stable. What led to this change and why has modernization funding declined so significantly?**

There are several drivers that are causing the decrease in funding spent on DME. First, over the past several years the IRS had to implement costly legislative mandates such as the ACA, FATCA and the ABLE Act. This required development of new systems capabilities, which once deployed move into production and require ongoing operations and maintenance (O&M) costs. Second, as we developed and deployed capabilities that support taxpayer services and enforcement programs such as Web Applications and Return Review Program, these new capabilities also require O&M funds to sustain. Third, the impact of diverting funds to implement these and other legislative mandates, and the associated O&M cost to support them and the modernization projects, increase our aged infrastructure to unacceptable levels. The IRS has focused its resources on addressing that aged infrastructure.

- b. What efforts has the IRS made to reduce the percentage of funding spent on operations and maintenance, which is set to be over 80 percent of the IT budget in the coming year?**

The IRS is constantly exploring options for reducing the operations and maintenance (O&M) costs as new technological solutions emerge that could replace more costly legacy methods. In addition, the IRS evaluates work processes for efficiencies, including redundancies of capabilities in systems that could be eliminated. Some IRS successes in reducing O&M costs are as follows:

- Implemented Convergence Unified Communications, which combines multiple services – such as voice, video and data – through a single provider to deliver greater functionality and capabilities and annual savings of \$25-\$30 million.
- Integrated Enterprise Portal (IEP). IRS has been able to maintain 100% availability for its IRS.gov offering while reducing its annual Infrastructure Operations and Maintenance cost on its IEP by approximately \$1M in FY 2015, \$2M in FY 2016 and \$7M in FY 2017 through innovation and contract negotiation. Support for this time period was covered by two different contracts.
- Implemented an Enterprise Storage Service rather than the legacy method of procuring/owning the storage solutions. This saved the IRS \$34 million from 2013 through 2016.
- Improved systems administration from 2015 – 2017, increasing the number of servers that are administered by a single administrator from 50:1 to 376:1. The resulting efficiencies allowed system administration resources to be reassigned to provide targeted support to other operations work rather than hiring new staff.

In addition, three significant efforts underway that will reduce O&M costs over time include:

1. Migration to cloud technologies, which can simplify business operations by centralizing services while minimizing operational costs by enabling convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services). Migration to cloud technologies will also facilitate a reduction to our aged asset inventory and out-of-date software.
2. Development and implementation of an Enterprise Case Management (ECM) solution, which would consolidate multiple case management systems. Once the ECM solution is developed and fully implemented, it will provide an enterprise platform with common infrastructure and common IRS business functions and services. We expect cost reduction over time, as well as improved ease of interactions for taxpayers with the IRS with simplified and improved digital communications.
3. The IRS is exploring the implementation of bot technologies, which are designed to automate the kinds of tasks normally performed by a human. Typically, bots perform tasks that are both simple and structurally repetitive, at a much higher rate than would be possible for a human alone. When implemented, this would allow us to use our labor more efficiently.

c. Does the IRS expect this trend to continue in future years?

This trend is expected to continue in the near term while IRS seeks to reduce the backlog of obsolete hardware, reprogram dozens of processing systems to account for tax reform, and continue the transition away from legacy platforms. Completing the transition to modern systems will eventually yield long-term O&M savings and efficiencies by allowing IRS to retire inefficient, manual platforms and processes. The timing of these savings and the future distribution of funding between O&M and DME will be determined by a number of factors including new tax legislation, taxpayer demand for online services, trends in cybersecurity, and other constraints. Even so, we are making progress. We use the technology roadmap to guide all solution design work, including implementation of legislative mandates. As a result, we are advancing toward the vision we set for how IT will operate in the future, both directly and indirectly.

3. The Government Accountability Office (GAO) has reported that the IRS does not have a process for prioritizing its modernization activities, which it spent \$800 million on in FY 2016.

a. Without a process, how does the IRS decide which modernization projects to dedicate resources to?

To clarify, GAO report 16-545, *IRS Needs to Improve Its Processes for Prioritizing and Reporting Performance of Investments*, states the following:

While IRS has developed a structured process for allocating funding to its operations activities **consistent with best practices**, it has not fully documented this process. IRS officials stated this is because the process is relatively new and not yet stabilized. In addition, IRS does not have a structured process for its modernization activities, because, according to officials, there are fewer competing activities than for operations activities.

Since the GAO report was issued, the IRS has documented the process for the Operations Support appropriation, and provided a copy to GAO (see attached). The process is the IRS's IT annual Portfolio Investment Plan (PIP) process. Through the PIP process, IT categorizes and prioritizes all IT demand related to the Operations Support appropriation into eight repeatable groups and within each group further classifies the requirement by operations/maintenance (O&M) or development /modernization /enhancement (DME), plus the filing season relationship or other internal priority designations. With limited resources and IT demand far exceeding available funding, this level of transparency facilitates leadership decision-making about where to apply funding based on priorities. Approximately 60% of our DME spend is covered as part of this process. To address the second part of the GAO recommendation, the IRS is in the process of documenting the prioritization process **of the remaining modernization activities** that are funded from the Business Systems Modernization appropriation. The IRS does have a process to ensure resources are aligned to the highest priorities including modernization. However, as stated above, at the time of the GAO report that process had not been documented. In a memorandum dated November 2, 2017, the IRS Commissioner established the foundational enterprise requirements that are the Service's highest priorities. These priorities are critical staffing (i.e. building redundancy in key areas, ensuring attrition does not put critical operating systems at risk, and closing skills gaps), Cyber and data security, refreshing aged technology infrastructure, and modernization/Reform Plan projects such as Web Applications, Return Review Program, Enterprise Case Management, etc. The IT priorities are aligned with IRS and Treasury priorities.

b. Who ultimately makes these decisions?

As stated in response to question 3a, the IRS Commissioner, with input from the IRS Senior Executive Team (SET), establishes the overall priorities for the IRS. The IRS's Chief Information Officer is responsible for approving the IT resource allocation, including modernization projects, to ensure they support the IRS corporate priorities and vision.

c. What is the role of the IRS Chief Information Officer (CIO) in this process?

The CIO is a member of the IRS SET and plays a role in determining the priorities for the organization. See response 3b above. The CIO has added responsibility for approving IT resource allocation, including modernization projects, to ensure they support the IRS corporate priorities and vision.

d. The IRS told GAO there is no documented formal process because there are less competing interests so it is not necessary. However, the IRS has also argued that it does not have enough funding for its modernization efforts. Given the limited resources, why has the IRS not had an institutionalized process to ensure funds go to the agency's priorities?

IT has a process for prioritizing all IT demand and, in fact, the IRS SET prioritizes all major investments. As stated in the response to question 3a, the IRS documented the process for the Operations Support activities and is in the process of documenting the process for

prioritizing the activities in the Business Systems Modernization appropriation. These processes, in conjunction with the IRS Commissioner's corporate priorities, provide a comprehensive framework that brings a long-term, repeatable, and rigorous process to all facets of IRS strategic planning – including project planning, programming, budgeting, and performance management.

e. If adequately funded, does the IRS have an estimate for how long it would take and at what cost to modernize all IRS IT systems?

As one of the largest financial institutions in the world, IRS supports hundreds of millions of taxpayers, requiring a large and incredibly complex IT ecosystem consisting of approximately 400 applications and over 200,000 hardware assets. Assigning a time estimate and costs to modernize all IRS IT systems is not feasible given the enormity of the IRS IT environment. However, IRS does have plans to modernize major components of the IT ecosystem as part of our Technology and Digital Roadmap.

In addition, an IRS IT infrastructure currency effort prioritizes the modernization of our operational hardware and software components. IRS is currently developing plans to address our aged infrastructure and is looking to cloud-based approaches.

f. Since GAO's report was released last year, what steps has the IRS taken to institute a process for its modernization efforts?

See response to question 3a.

g. The Treasury Inspector General for Tax Administration (TIGTA) testified the IRS needs to improve its project planning prior to starting development activities. What actions has the IRS taken to address these concerns?

The IRS has a long-standing history of applying system lifecycle methodologies to application development projects. We are applying these practices more holistically across a broader spectrum of IT projects. While we have more work to do in this regard, including documentation of certain processes, we believe we are on a good track.

As an example, since adopting new methodologies like Iterative and Agile, the IRS is able to augment traditional methodologies such as waterfall. The waterfall methodology was traditionally used for large scale modernization efforts lasting several years, with requirements gathering, design, development, test, and knowledge of all capabilities locked down up front for the entire lifecycle of the project. By planning with Agile and iterative technique, our collaborative effort with the business and IT delivery partners allows us to define high level capabilities and prioritize their value and impact. We then can develop and deliver them incrementally so the customer can start realizing business results much sooner than a waterfall, 'big bang' approach to delivery. Once initial capabilities are delivered, the business then better understands the needs and priorities, and this new insight is factored into the next set of capabilities to be developed. As we experimented and transitioned to the new agile development approach, more clarity and better sequencing of planning activities have evolved.

Even so, the IRS conducts planning activities prior to solution design and development, including conducting market research, alternatives analysis, information sessions with industry and other agencies, to learn about new technologies and experiences in applying them, as well as performing prototypes and pilots, as appropriate. As IRS inserts new technology we align it to the overall mission and strategy of the IRS and perform readiness activities for the organization. IRS also has a rigorous governance process that serves as a decision-making entity and includes all stakeholder groups to ensure cost, schedule, scope and priorities are clearly established and monitored throughout the lifecycle of an IT project.

4. Customer Account Data Engine 2

a. What year did the IRS determine the Individual Master File (IMF) would need to be replaced?

In 1999, IRS made the decision to focus on replacing Assembler Language Code (ALC) systems, beginning with the Individual Master File (IMF), and subsequently the Customer Account Data Engine (CADE) Program was launched in 2000.

b. In what year did the IRS begin developing a strategy for CADE 2?

In 2008, the IRS created a core team to explore an approach to modernize the IMF and address issues in the ongoing CADE approach. Building upon the work already done in CADE, a new approach was developed to accelerate development of a centralized taxpayer account database (the “CADE 2 Database”), with a plan to complete implementation in three transition states:

- **Transition State 1 (TS1 – COMPLETED):** Build out and stabilize a complete CADE 2 database, start using the CADE 2 database for on-line access and data extracts to other IRS systems, and shift from weekly processing to daily processing to improve taxpayer service.
- **Transition State 2 (TS2 – 3 OF 6 RELEASES DELIVERED) –** The most complex Transition State which encompasses the goal of modernizing the core IMF components—where majority of the tax law is embedded—from ALC to Java. Originally, this transition state was also expected to make CADE 2 the Authoritative Data Source (ADS) for financial and legal purposes and address the Financial Material Weakness (FMW) for individual taxpayer accounts. However, due to resource constraints and competing priorities, all outstanding projects associated with these two goals have been paused and will be deferred to a later transition state.
- **Transition State 3 (TS3):** Following modernization of the core IMF components in TS2, TS3 will modernize the remaining IMF components including IMF preprocessing (validation and acceptance of tax transactions) and post-processing applications (distribution of taxpayer information to other IRS and external systems). Retire the IMF sequential files.

c. What was the initial cost estimate for the project?

The initial planned cost in January 2010 for the development of CADE 2 TS1 and TS2 was \$435 million. Costs associated with TS3 were not estimated at that point in time. Given the size and magnitude of the TS1 and TS2 effort, there was insufficient information to determine the scale of impacts to interfaces and downstream system that would need to be addressed in TS3, as well as internal IMF complexities.

d. What is the total cost, to date, of CADE 2?

As of October 31, 2017, the total cost of CADE 2 is \$1.2 billion—\$1.16 billion from Business Systems Modernization (BSM) activities and \$40 million from Operations and Maintenance activities. These funds support a multitude of activities needed to drive the program forward including: program planning and management, project management, architecture and engineering, prototype development, vendor comparisons for conversion tools, requirements development, harvesting of business logic from the existing code base, testing (performance, user, security, data generation), detailed design development, coding, infrastructure procurement, cyber security planning and scans, technical integration, organizational readiness and change management, and more.

e. What is the annual cost of running and maintaining the IMF?

The IRS spends approximately \$15 million per year in direct costs to maintain the IMF. There are additional indirect costs such as training and system/database administration expenditures that are not included in this direct cost estimate.

It is important to understand that cost is not the primary driver for modernizing the IMF. The primary driver is to ensure access to and protection of the data as an enabler to real-time transaction processing in support of modernizing the taxpayer experience.

f. When was the initially planned completion date for CADE 2?

When the IRS initiated TS2, the most complex of the Transition States, the final release was planned for deployment in the 2020 filing season. This timeline was considered a stretch goal at the time with several key assumptions, including a) availability of funding to acquire contract support for specialized skill sets and b) hiring of additional IRS FTEs to backfill attrition in key positions (especially technical leadership). These assumptions were never realized due to budget cuts and associated hiring freezes over several years.

TS3 will modernize the remaining IMF components including preprocessing (validation and acceptance of transactions) and post settlement applications that are still written in ALC. It will focus on integration – tying the data to the application and making it available to downstream systems for operational use- as the IRS works to retire the IMF sequential file and begin to update the database directly. A final timeline has not been estimated for this phase.

g. What is the planned completion date of CADE 2?

TS1 was completed in 2012, TS1.5 was completed in 2014, and TS2 is currently underway. As of FY 2017, TS2 was targeting completion in 2024. However, due to anticipated funding reductions, competing priorities, and staffing/hiring constraints, some scope elements/releases originally planned for TS2 have been deferred to future transition states. All available resources are now directed to TS2's most critical goal, reengineering the IMF core components, the most complex and risky portion of the system, where the majority of the tax law is embedded. The CADE 2 Release plan was updated and approved in January 2018 to reflect TS2's reduced scope with a new TS2 target completion in 2021-2022. There is not yet a target completion date for TS3. At this time, it is estimated that several years of work will remain to address TS3 goals and fully complete CADE 2. TS3 goals include replace all legacy reporting, add functionality to address the FMW for individual taxpayer accounts, make CADE 2 the ADS, and modernize feeds to downstream systems. These assumptions may change based on FY 2018 enacted appropriations.

h. When will the IMF be taken offline?

As noted above, current plans call for the IMF to be taken offline at the completion of TS3 of CADE 2 (see answer to question 4d above). With the deferment of scope from TS2 to TS3 resources and funding levels must be stabilized and assessed to determine impacts to the current strategy of three Transition States. Until this is completed, it will be difficult to predict when all components that support the IMF can be retired.

i. What functionality has been achieved through CADE 2 thus far?

- Accelerated from weekly to daily tax processing, resulting in faster refunds, notices, and availability of more current taxpayer information across the IRS to serve taxpayers more effectively. In addition:
 - Tax payments, returns, and other transactions are uploaded and updated on taxpayer accounts faster.
 - The time required to complete a merge of taxpayer information has been shortened, which helps to resolve issues such as identity theft more quickly.
 - IRS taxpayer assistors can view taxpayer account information within two days of the planned posting of new taxpayer information (previously, the timeframe was two weeks).
- Launched the CADE 2 Database, successfully migrating all individual taxpayer account information (approximately 290 million accounts and over a billion tax modules) from legacy sequential flat files to a modern relational database, establishing the IRS' data-centric foundation for the future.
- Migrated Corporate Files On-Line (CFOL), the IRS' taxpayer account viewing system, from the IMF to the CADE 2 database.
 - Result was taxpayers and IRS assistors use CADE 2 data when viewing tax data online, a critical step in replacing IMF.
- Established CADE 2 Operational Data Store (ODS) within the IRS' enterprise data warehouse, making up-to-date individual taxpayer data available to the Business and CFO for reporting and analysis.

- Established self-service reporting and analysis capability using the CADE 2 ODS as the data source, enabling the IRS Business and CFO to perform ad hoc queries and generate reports using up-to-date individual taxpayer data.
- Improved currency of the data within the enterprise data warehouse by refreshing daily (previously was monthly).
- Deployed database year-end conversion capability that allows IRS to retain expanded taxpayer history from the previous tax season for the first time ever, improving taxpayer service and enhancing IRS compliance enforcement.
- Took significant steps toward addressing the Financial Material Weakness for Individual Taxpayer accounting:
 - Implemented common Penalty & Interest (P&I) code across IMF, Business Master File (BMF) and Integrated Data Retrieval System (IDRS) resulting in consistent and accurate P&I calculations on taxpayer accounts and financial statements. No projectable P&I errors were identified for fiscal year 2016 during the Government Accountability Office's annual audit.
 - Implemented functionality to include Pending Payment Transactions in the unpaid assessment balance, improving IRS financial statement and reporting accuracy.
- Modernized one of the IMF's most complex set of financial reports (Financial Recap Reports) that is used to feed the IRS General Ledger and deployed to Production in parallel validation mode (provides the opportunity for the Business to confirm the accuracy of the CADE 2 financial reports by comparing results to the IMF).
- Developed and tested a code conversion tool that moved IMF business rules from ALC into intermediate Java code, allowing the use of modern Java tools to perform analysis as we modernize. We have launched the effort to re-write the core IMF components in Java, using the intermediate Java code to identify IMF code related to the most critical business functions and to prioritize early development of those functions. This intermediate code has also solved some critical design problems related to ALC coding constructs that were developed in the 1960's when efficiently using limited CPU and storage capacity was more important than ease of maintenance.
- Implemented an innovative legacy code analysis, documentation and knowledge transfer methodology, enabling us to expand the number within our IT community who have knowledge of the most critical piece of individual taxpayer processing.

j. What functionality has yet to be completed?

- Continue ongoing efforts to modernize core IMF components—where most of the tax law is embedded—from legacy ALC to Java platform, perform extensive parallel validation, and retire the core IMF components.
- Modify the modernized Java components to update the database directly and retire the IMF sequential files.
- Make the CADE 2 database the Authoritative Data Store (ADS) for financial statements and reports (and the annual GAO financial statement audit).
- Address the Unpaid Assessment Financial Material Weakness (FMW) for individual taxpayer accounts.
- Modernize the front-end of the system that accepts and validates transactions from upstream systems, as well as the back-end of the system that generates notices and

other operational, customer service and compliance information to downstream IRS systems.

k. Is the IRS still committed to replacing IMF via CADE 2, and if so, why is the planned FY 2018 spending for CADE 2 significantly lower than prior years?

Replacing the IMF with CADE 2 remains one of the IRS' highest priority projects. CADE 2 has been re-planned to prioritize modernizing the IMF core components- where of most of the tax law is embedded- from legacy ALC to Java (see additional details in (l) below).

l. CADE 2 is considered one of the IRS' most significant modernization efforts and yet it is currently under a strategic pause while its release plan is being revised.

The CADE 2 Program is not under a strategic pause but specific CADE 2 TS2 projects are currently paused to prioritize modernizing the IMF core components- where of most of the tax law is embedded- from legacy ALC to Java.

i. What is the current status of CADE 2?

All CADE 2 resources are now directed to the one, most critical CADE 2 project: modernizing the core IMF components from legacy ALC to Java. All remaining CADE 2 TS2 ADS and FMW projects have been paused to allow resources to focus on modernizing the core components of the IMF. The CADE 2 TS2 Release Plan (v5.0) was updated and approved in January 2018 to reflect these changes.

ii. What date did the strategic pause begin?

The pausing of specific CADE 2 TS2 projects was conducted in waves. The first wave, executed in January 2017, addressed resource constraints, specifically IMF subject matter experts that could not support the conversion of IMF core components, FMW, and ADS projects in parallel. This resulted in pausing of FMW-related projects. The second wave occurred in June 2017, resulting in pausing a subset of ADS-related projects. , the third wave occurred in September, October, and November 2017 resulting in the pause of the remaining ADS-related projects. (See attached Release Plan v4.2 for a list of projects, description, and dates related to deployment, pause, and anticipated start date.)

iii. When is the strategic pause scheduled to end?

As noted above, the CADE 2 program is not under a strategic pause but has paused certain TS2 projects and directed all budgeted resources to its most critical project: modernizing the core IMF components from legacy ALC to Java. The IRS will re-evaluate this approach throughout the year

iv. Why is the release plan being revised?

The release plan was updated in January 2018 to defer scope from Releases 4, 5, and 6 in TS2 to a future transition state to reflect the Program's focus on modernizing IMF core components from ALC to Java, and the pausing of ADS and

FMW projects. NOTE: Deferring ADS and FMW-related projects from TS2 to TS3 will push the overall timeline to complete CADE 2 and retire IMF.

v. When will the revised release plan be completed?

The CADE 2 TS 2 Release Plan (v5.0) was updated and approved by the Executive Steering Committee (ESC) on January 26, 2018.

vi. Please describe any anticipated changes to the CADE 2 release plan.

As described above, the release plan was updated to reflect the Program's focus on modernizing IMF core components from ALC to Java and the pausing of ADS and FMW projects. The pause of these projects will push the overall timeline to complete CADE 2 and retire IMF.

m. The IRS CIO testified that CADE 2 could be completed in five years if the IRS receives an additional \$85 million per year and an additional 50 to 60 full-time equivalents. Please describe how the IRS determined this estimate.

The five-year timeline referenced by the IRS CIO was specific to completing the modernization of the core IMF components (where majority of the tax law is embedded) from ALC to Java, not to the completion of the full scope of CADE 2. CADE 2 can deliver the modernized IMF core components to production, followed by one year of parallel validation, resulting in retiring the legacy runs.

n. Is there a strategy to address IT workforce gaps, especially as it relates to the IMF? If so, please describe.

IT workforce gaps pose a very real risk to maintainability of the IMF system moving forward, as the number of developers who know and understand the technology and tax law business rules are decreasing at an alarming rate. Many of the existing developers are eligible for retirement, the team is already understaffed, and there are not sufficient candidates available to backfill behind them because the technology is outdated and skills do not exist in the marketplace. Each year, it becomes increasingly challenging to implement new tax law changes and production fixes due to the decrease in knowledge of how the system works.

To mitigate these workforce risks in the short term the IMF Stabilization Plan was developed in 2016. The Plan describes detailed mitigation activities that are planned and/or taking place for specific resource and skillset gaps. This plan is revisited and refined monthly. The next revision will further define our strategy to maintain core IMF components, while preparing to transition existing staff to the modernized components once completed. Hiring staff is dependent upon the necessary funding and approvals to hire in order to close the gaps.

5. Enterprise Case Management (ECM) Program. The ECM Program is reported to have paused all development activities. While the Committee understands the need to consolidate the number of ECM systems that the IRS maintains, please provide acquisition timeline(s) for the one or more

ECM systems that the IRS anticipates acquiring and a list of the business units or divisions that each ECM system will be used for.

The IRS is currently developing a request for quotations (RFQ) for issuance in mid calendar year 2018 that will allow the IRS to choose two vendors to execute challenge-based scenarios (known in the industry as a First Article Test). The First Article Test will provide limited funding to two vendors to install their product in the IRS IT environment and have the IRS test key functionality. Based on the First Article Test, the IRS will then select one or more products to license to resume development of an enterprise-wide case management system in early 2019. Implementation order will be more along similar lines of business (such as Exam or Collections) rather than business unit/division.

All activities beyond the RFQ stage are subject to the availability of staff and funding.

a. The ECM stopped development due to "technical limitations" of the commercial off-the-shelf product according to TIGTA's testimony. Please describe these technical limitations in detail.

In November 2016, the IRS sent MicroPact, vendor of the entellitrak commercial off the shelf (COTS) product, a list of 37 operational problems related to using entellitrak to develop the ECM system and requested that MicroPact address the problems. The 37 problems were categorized into five levels of criticality:

1. Major (seven problems) - Direct impact on the ability to perform development and/or incorporate entellitrak into ECM Continuous Integration/Continuous Delivery processes that support multiple development teams, automated testing and automated software deployment.
2. High (twenty problems) - Significant impact prohibiting the ability to support large software development teams, integrate to automated tools for software code control and automate software deployment to production. The vendor's recommended resolution to these issues required manual work arounds or unacceptable mitigation strategies.
3. Moderate (four problems) - Elevated impact requiring minimal manual mitigation strategies to resolve. The inability to customize the entellitrak user interface for particular users is included in this group.
4. Nominal (four problems) - Impact requiring assessment of manual vs. automated mitigation strategies to ensure ECM development can move forward. Software code promotion through a plug-in would be an example.
5. Minor (two problems) - Minor impacts that can be addressed with a manual mitigation strategy.

By January 2017, only seven of the 37 problems were closed and the remaining 30 were open. Additionally, any commitments for product enhancements to address these issues would not be available for validation for more than 24-36 months.

b. When was this ECM solution procured?

The ECM Program was launched in early 2015 with a COTS product—MicroPact’s entellitrak software platform—that was already in use in the IRS IT environment. At that time, entellitrak Windows platform had been in use at the IRS since 2008, and was used successfully to support 14 separate business processes.

c. When did the IRS become aware of these technical limitations and how did the IRS become aware of them?

In September 2014, IRS performed a technical review for Organizational Hierarchy functionalities for the Taxpayer Advocate Service Integrated System (TASIS) with entellitrak. The Technical Issues/Concerns & Lessons Learned Overview for that demonstration reported that this Windows-based version of entellitrak:

- Had not proven it can be scalable to IRS needs
- Did not have the ability to customize the entellitrak user interface for a particular user
- Did not have Continuous Integration capability
- Did not entirely insulate its source control

The IRS continued to use entellitrak because a new version of the software, version 3.23, based on the Linux operating system, promised significant improvements over the older, Windows-based version. Entellitrak also had a proven track record at the IRS, supporting 14 business systems using the entellitrak/e-Trak platform. It was only with hands-on, large-scale development work with proposed ECM “early deliveries” in the latter half of 2016 that the IRS became aware of the breadth and depth of the issues with the latest version of entellitrak. As a result, the IRS launched a deep dive analysis over the summer of 2016 to explore and document all issues with entellitrak that could prevent it from being effective, as an enterprise-wide ECM platform. This analysis confirmed issues with the software platform, including those associated with managing developer's code, automated processes for deploying the application, scalability, upgrade path compatibility and user interface.

In November 2016, the IRS sent MicroPact, the vendor of the entellitrak COTS product, a list of 37 operational problems related to using entellitrak to develop the ECM system and requested that MicroPact address the problems (described in 5a above). Based on MicroPact’s response and ongoing discussions with the vendor, it was concluded in early 2017 that the IRS needed to find another solution for enterprise case management. Leveraging the work that had been completed and the lessons learned from the MicroPact experience, the program defined and launched a product assessment and acquisition strategy to identify and evaluate a suite of products with core capabilities that were scalable and best aligned with IRS future state to serve as the foundation for an enterprise case management platform. Our learnings were augmented by information exchanges with other agencies about their experiences in implementing enterprise case management, two requests for information (RFI) from the vendor community and an analysis of

applicable audit findings and recommendations. The accumulation of all this data was the basis for the request for quotations (RFQ) under development.

d. When did the IRS stop development of this ECM?

Based on the deep dive analysis and input from MicroPact about when they could or could not address the issues raised by the IRS, the IRS paused development of ECM in November 2016. An orderly shutdown of all development activities was conducted, as the ECM projects received Governance Board approval to cease development work. The IRS then conducted a retrospective evaluation of the program to date, identifying lessons learned and solution components that could be leveraged going forward. The ECM Program also developed a Go-Forward Plan and received approval to move forward with the ECM Product Assessment and acquisition strategy (described in question 5g below).

e. What is the current date for completion?

The IRS is currently developing a Request for Quotations (RFQ) for issuance in mid-year 2018 that will allow the IRS to choose vendors for challenge-based scenarios (First Article Test). The First Article Test will provide limited funding to two vendors to install their product in the IRS IT ecosystem and allow the IRS hands-on access to technical and business capabilities. Based on the First Article Test, the IRS will then select one or more products to license to resume development/implementation of an enterprise-wide case management system in early 2019. All activity past the First Article Test stage is subject to the availability of staff and funding. Based on our learnings from other agencies and the scale and complexity of the legacy case management systems across the IRS, this will be a multi-year program.

f. Why were these technical limitations not identified prior to the procurement of the ECM?

The entellitrak platform had been used successfully by the IRS for many years prior to the launch of the ECM Program in 2015. There were no major problems with any of the applications that were leveraging the product. Only in the "Early Deliveries" development work in 2016 did problems begin to emerge that would question the use of entellitrak as an IRS-wide enterprise case management platform. The IRS launched these early deliveries precisely to learn about implementing solutions with entellitrak and discover any issues or constraints that might impact the solution architecture. As issues surfaced, the vendor assured the IRS that there were feasible workaround strategies that had been successfully used with other clients to address the technical constraints. Only after hands-on development and extensive analysis with the MicroPact did the IRS determine that these workaround strategies were inadequate to support an enterprise solution of the scale required for IRS. These issues reached a critical point in 2016 (see response to 5a and 5c above) with the detailed documentation of 37 operational problems with the use of entellitrak.

g. What steps has the IRS taken and what safeguards has it put in place to ensure this situation does not occur again?

The IRS has defined a strategy and taken a number of actions to ensure that the selection of the product(s) for delivering Enterprise Case Management will meet both business and technical requirements. These reflect the analysis and lessons learned from the entellitrak experience as well as interviews with numerous agencies implementing programs of similar scope and scale. In November 2016, the IRS paused ECM development work and followed standard processes to stand down all development work, focusing on conducting a retrospective evaluation of the program to date, identifying lessons learned and solution components that could be leveraged going forward. The IRS approved a robust ECM Product Assessment approach and acquisition strategy in April 2017. This product assessment is based on a strategy proven in government and includes a challenge-based acquisition process leveraging strong industry engagement along with multi-phased awards with challenge-based scenarios to validate sustainability for IRS operations and business functionality.

In the summer and fall of 2017 the IRS developed and issued two Requests for Information (RFIs) to solicit industry perspective on Enterprise Case Management solutions. The IT and Business ECM Program Management Offices also studied GAO and TIGTA reports on related projects, identifying lessons learned and best practices to apply to ECM. They also met with invited federal and state agencies to share lessons learned from implementing solutions of similar complexity and demands on their organization. Nearly all the experiences shared by other agencies were multi-year projects with valuable lessons learned occurring between 2013 and the present time. These agencies were attempting to address technical challenges and execute transformational changes to existing business processes of similar scale and complexity at the same time as the IRS. Many of the agencies the IRS met with had significant initial challenges with tools and solutions similar to those experienced by the IRS. The IRS believes the capabilities of COTS products and cloud technology have undergone a significant change in the past few years, so the new market research and acquisition strategy is critical to determine the best product(s) that meet the IRS' business and technical requirements.

The IRS invited ten vendors (eight product developers and two solution integrators) to demonstrate products and discuss solutions presented in their response to RFI #1, and subsequently invited four vendors in for more in-depth, scenario-based demonstrations based on responses to RFI #2.

The IRS is currently developing a Request for Quotations (RFQ) for issuance in early 2018 that will allow the IRS to choose two vendors for challenge-based scenarios (First Article Test). The IRS has determined minimum mandatory requirements to specifically address the lessons learned from entellitrak, as well as more than 300 business and technical capabilities and requirements. The First Article Test will provide limited funding to selected vendors to install their product in the IRS IT ecosystem and allow the IRS hands-on access to technical and business capabilities. Based on the First Article Test, the IRS will then select one or more products to license to resume development of an enterprise-wide case management system in early 2019. All activity past the First Article Test stage is subject to the availability of staff and funding.

6. In December of 2010, the U.S. CIO directed agencies to shift to a cloud first policy.

a. What steps has the IRS taken to move its systems to the cloud?

The IRS has developed and approved Version 1 of an enterprise-wide cloud strategy. The IRS Cloud Strategy will be the foundation for work to achieve tangible cloud results and will be updated routinely. The IRS Cloud Strategy addresses a path to:

- Drive cloud adoption by creating processes to select, manage, and inventory cloud-based services at IRS.
- Develop appropriate risk frameworks to ensure safe cloud adoption
- Develop a roadmap to assess and migrate legacy IRS IT capabilities to the cloud. We anticipate significant cost savings once migrations are completed. Additionally, IRS has begun work within and across its IT units to push forward with cloud adoption. These steps, which are in-flight as of March 2018, include:
 - Developing a target state architecture for the IRS Cloud
 - Drafting RFI to engage cloud vendors in discussions to better understand the marketplace for cloud services and collecting RFP requirements to procure cloud services
 - Developing security architecture for IRS Cloud
 - Standing up appropriate management and governance structures for Cloud adoption and Cloud operations at IRS in order to facilitate migration.
 - Assessing numerous IRS applications across technical, risk, and pricing dimensions to determine cloud suitability and recommendations for cloud migration.

Several IRS applications (including MoveLINQ, eFOIA, and eDiscovery) have moved or are currently moving to the Cloud, following the Software-as-a-Service (SaaS) service model. In addition, IRS has network upgrades underway, which will enhance secure connectivity between the IRS and Cloud service providers.

b. And when did the IRS deploy its first cloud?

IRS has used cloud technologies and managed services strategically in the past several years and has used these experiences to help shape our cloud strategy. Examples of early cloud implementations include:

- The IRS implemented the Enterprise Storage Solution (ESS) in FY2014.
- Foreign Account Tax Compliance Act (FATCA) International Data Exchange Service (IDES). - Amazon Web Service (AWS) – IRS Authority-to-Operate (ATO) to GSA in 2015 and then reviewed and updated on 2/7/2017
- Integrated Enterprise Portal (IEP) – a secure managed service private cloud. Uses Akamai cloud service for content distribution. – IRS ATO to GSA on 7/12/2016
- Web Content Management System (WCMS) – Acquia Cloud to support IRS.gov – IRS ATO to GSA on 7/26/17
- MoveLINQ - Financial relocation management software to SaaS based cloud provider – IRS ATO to GSA on 9/22/2017

c. What are the security implications of failing to implement an IRS cloud strategy?

There are multiple security benefits the IRS hopes to achieve by implementing cloud technology:

- Due to the superior speed and agility enabled by cloud, security vulnerabilities of cloud applications can be addressed more rapidly.
- The centralized management and high degree of standardization and automation enabled by cloud ensures consistent and rapid security action and responses across the portfolio of applications/services hosted in the cloud.
- Cloud vendors adhere to strict security requirements that can be tailored to IRS needs, and reviewed, tested, and approved in advance to ensure compliance with IRS and NIST standards. All applications in a cloud environment inherit a strict set of baseline cloud security controls, ensuring high degree of security and consistency.
- Implementing cloud ensures that infrastructure utilization is maintained at the optimal level, decreasing risks associated with maintaining excessive physical infrastructure.

d. Why was there a six-year delay before the IRS began to consider a cloud-first strategy, as mandated by the U.S. CIO?

At the time the U.S. CIO directive was issued, many of the industry mechanisms necessary to execute a cloud-first strategy were not yet in place. At that point, the market was still maturing in several important respects, including the proven capabilities/offerings of cloud vendors, federal guidance around cloud security, and most importantly the understanding of security risks specific to cloud. Given the paramount position of security and the data security/privacy requirements of IRS under section 6103, the agency took a low-risk approach and continued to monitor the maturity of the market. FedRAMP security controls were released in 2012, and the first FedRAMP Authority-to-Operate (ATO) was issued in May 2013. Once the market of cloud vendor offerings, federal guidance, and cloud security advanced to greater maturity, the IRS began exploring cloud. In 2012, the IRS implemented the Enterprise Storage Solution (ESS), Storage-as-a-Service, cloud-managed service solution offering, while the International Data Exchange System (IDES) went live in January 2015. IRS successfully used cloud technologies and managed services strategically and opportunistically in the past several years, per the examples provided for question 6(b). Given the numerous successful cloud implementations across federal agencies in the past few years, IRS has developed and approved (in December 2017) its enterprise-wide cloud strategy, which addresses the "cloud first" directive.

7. What is the IRS's process for determining and prioritizing which online account features or functionalities will be added next to existing online services?

The IRS determines and prioritizes the addition of new features and functionalities to online accounts by evaluating and prioritizing proposals led by a cross-functional team. The proposals are evaluated and ranked against both previously proposed online account capabilities and other capabilities within the Web Apps scope. This process is facilitated by the Web Apps PMO and begins when IRS business units propose new features/capabilities for online accounts through a well-structured intake methodology. The proposals are evaluated by the business operating unit, Online Services and IT, and scored across multiple dimensions. A list of scored capabilities, also referred to

as the “product prioritization backlog,” is reviewed regularly by a core team made up of the business units and IT, which selects capabilities to be proposed for development based on the score. The proposals and any dependencies are reviewed and dispositioned by the Web Apps Governance board, the Digital Subcommittee and the Strategic Development Executive Steering Committee. Approved entries go through a product elaboration process where the team discusses the requirements and design before transitioning the capability to the development teams.

Once approved, features and functionalities are delivered using an agile delivery model that emphasizes adaptive planning, evolutionary development, continuous improvement, and encourages rapid and flexible response to change. The development and delivery of features for online accounts are managed using a product backlog, which reflects user stories for each approved feature. Development activity prioritizes the planned features based on application metrics, user testing/feedback, and business priorities. Generally, new features have been released approximately every 9 weeks.

8. While the IRS has reported a significant decline in self-reported cases of identity theft, how does the IRS address individuals who may be unaware of having had their identities stolen?

We take all types of tax-related identity theft fraud seriously. We have expended substantial resources to identify and stop tax-related fraud and the victimization of innocent taxpayers when their personally identifiable information is used to file a tax return. When we identify tax-related fraud, we make every effort to notify the taxpayer and assist them in taking the necessary steps to protect their identity from further misuse. The notification depends on how we detected the tax-related identity theft. There are instances where we are unable to notify them because we do not have a valid mailing address.

For example, when an attempt to electronically file a tax return is made which includes a Social Security number (SSN) already used or listed on another return for the same tax year, the return is rejected. The taxpayer receives a rejection message through the e-File system which alerts them that they may be a victim of identity theft. After receiving the reject notification, taxpayers generally call the IRS and assistance is provided. If a return was previously processed with the taxpayer’s SSN, the assistor instructs the taxpayer to file a paper return and attach Form 14039, Identity Theft Affidavit. The assistor will also provide the caller general identity theft information on how to protect their identity. In February 2018, The Federal Trade Commission (FTC), in cooperation with the IRS, updated their IdentityTheft.gov website to provide taxpayers reporting an identity theft incident with the opportunity to send a Form 14039 to the IRS. FTC’s Identity Theft questionnaire was updated to include questions for the taxpayer to complete. The questionnaire gathers the information necessary to complete a Form 14039 from the taxpayer. After completing the questionnaire, the taxpayer previously had to print the completed Form 14039, Identity Theft Affidavit, from FTC’s IdentityTheft.gov website and forward it to the IRS for processing. Now at the push of a button, the Form 14039 information is sent by FTC to the IRS, if the taxpayer informs FTC to do so. The data files containing the Form 14039 information, for taxpayers who chose to submit it to the IRS, are sent by FTC to the IRS daily through secure servers. The IRS takes the information received from FTC, converts it to a Form 14039, and processes it.

Here are other instances when the IRS sends notifications which may alert the taxpayer of potential identity theft:

- We notify taxpayers of questionable returns filed using their SSN when the returns are selected for review by the Taxpayer Protection Program. The letter informs the taxpayer we detected a tax return with indications of identity theft and asks them to confirm if they filed the return in question. After confirming their identity, if the taxpayer did not file the return, we take steps to assist them. If the taxpayer did file the return, we release the return for processing and issuance of the refund.
- We notify taxpayers, either directly or through an Electronic Return Originator, if we receive an electronically-filed extension request and our records show a tax return has already been filed for that tax year. We reject the extension request and notify the taxpayer that a return has already been filed using their SSN.
- We notify taxpayers who are potential victims of employment-related identity theft. The IRS defines employment-related identity theft as the misuse of another person's SSN to obtain employment. In January 2017, we began issuing a letter (CP01E) when a new incident of employment-related identity theft is identified. The letter is sent to the taxpayer whose SSN was listed on a Form W-2 which does not belong to that taxpayer. This notice alerts the taxpayer that we've taken actions to ensure there is no impact to their tax return or tax account, and they may wish to review the earnings posted to their Social Security Administration account.

IRS also works closely with the Federal Trade Commission to provide information and guidance on identity theft prevention and detection. Steps to follow if you are a victim are provided year-round at IRS.gov and emphasized during the national Security Awareness Week. For more information on IRS.gov see "Identity Protection: Prevention, Detection and Victim Assistance", "How Do You Report Suspected Tax Fraud Activity?" and "IRS Identity Theft Victim Assistance: How It Works".

a. Does the IRS have an estimate of how many taxpayers are victims of identity theft and are unaware of it?

The IRS is not able to estimate how many taxpayers are victims of identity (ID) theft and are unaware of it; however, we do estimate the extent of protected and unprotected identity theft through our annual Taxonomy. If the IRS identifies tax-related identity theft, we notify the taxpayers. It is possible that in the population of unprotected identity theft, the taxpayers may not be aware they are a victim. We are not able to offer an estimate of that population. The IRS does monitor the extent of identity theft refund fraud through our Taxonomy. This research-based effort aims to report on the effectiveness of IRS's identity theft defenses to internal and external stakeholders, help us identify identity theft trends and evolving risks. It also helps us to refine identity theft filters to better detect potentially fraudulent returns, while reducing the likelihood of flagging legitimate tax returns. Uncertainty exists because the *ID theft unprotected* figures represent an estimate of ID theft returns not stopped by the IRS defenses. To produce the estimate, IRS must distinguish these ID theft returns (that by-passed our defenses) from legitimate filings as well as first party fraud. This is a difficult task as ID thieves are attempting to present themselves as a legitimate taxpayer.

For 2016, ID theft returns unprotected are estimated to be between 740K – 810K (\$1.68 – \$2.31 billion in refunds); whereas ID theft returns protected are estimated to be between 1.98 million to 1.99 million (\$10.56 – \$10.61 billion in refunds). Both estimates are lower than they were in 2015 (estimated unprotected returns between 860K – 1.03M for \$2.24 - 3.34 billion in refunds; estimated protected returns 2.38M – 2.47M for \$12.35-12.88 billion in refunds).

b. If so, please describe the methodology for this estimate.

The Taxonomy estimates the number of identified identity theft refund fraud cases where IRS (1) prevented or recovered the fraudulent refunds, and (2) paid the fraudulent refunds. We break these estimates into categories corresponding to IDT detection strategies, which occur at three key points in the life cycle of a tax refund: before accepting a tax return, during return processing, and post refund.

9. What substantial IT cost savings have been achieved by the IRS in the last three years?

As Deputy Commissioner Tribiano shared during the hearing, IRS needs to do a better job of articulating the benefits from our IT investments. While there are substantial cost savings/reductions associated with some of our IT investments, in many cases the value in our IT investments are attributable to expanded services and performance improvements. Much like when you finally upgrade your old flip phone to a smartphone—it was not cost savings that compelled you to upgrade but rather new and expanded forms of communication and services necessary to remain functional in the current digital age. Likewise, cost savings/reductions are not always the compelling reason to modernize IRS systems. In many cases it is the need for expanded service to taxpayers, such as our web applications; to address proliferation of fraud detection, such as our RRP anomaly detection system; to create new operational efficiencies, such as our Enterprise Case Management enterprise platform and common business functions; or even to ensure long-term viability and security of our core tax processing systems and data, such as in CADE 2.

Following are examples of IT investments over the last three years where there was not only expanded business value but also substantial IT cost reductions realized:

- Integrated Enterprise Portal (IEP). IRS has been able to maintain 100% availability for its IRS.gov offering while reducing its annual Infrastructure Operations and Maintenance cost on its IEP by approximately \$1M in FY 2015, \$2M in FY 2016 and \$7M in FY 2017 through innovation and contract negotiation.
- Storage-as-a-Service. IRS's data storage strategy to maintain a manageable and scalable storage infrastructure under a private cloud managed service has shown cost savings of over \$34M from 2013 to 2016 and 12 petabytes of disk storage over a period of 36 months.
- Convergence Unified Communications. Modernization of IRS's disparate legacy networks infrastructure, from over 470 assets managed and maintained by dispersed teams of 108 FTE, to one unified system distributed geographically across 13 call control clusters maintained by 40 centralized engineers and technicians, showed

approximately \$49.7M in combined savings for FY 2015 to 2017 (total \$200M in savings projected from FY 2012 through FY 2021). As of FY 2017, converged network is showing savings of over \$25-30M annually in circuit costs and annual maintenance.

- Strategic Acquisitions. Use of strategic sourcing techniques in contract negotiations has resulted in nearly \$34M in major hardware and software savings realized in FY 2014 to FY 2016. IT cost savings were achieved by implementing centralized management of software licenses, increasing license utilization, licensing by more efficient use models, and effectively using total cost of ownership analysis to guide hardware purchases.

Source	Type	FY15 Savings
BMC Software Licensing	Software	3,101,774
IBM Mainframe Platform Refresh	Hardware	14,000,000
	Total	17,101,774

Source	Type	FY16 Savings
Oracle Licensing	Software	1,992,299
IBM Mainframe	Hardware	1,115,009
	Total	3,107,308

Source	Type	FY17 Savings
Microsoft Licensing	Software	11,775,232
Pitney Bowes Licensing	Software	1,950,708
	Total	13,725,940

10. What is the IRS's plan and timeline for replacing the 64 percent of the IRS's hardware that TIGTA determined is past the end of its useful life?

One of our biggest risks is our aging infrastructure. Over the last several years, we used our appropriated resources and user fees to maintain infrastructure components for our core filing season systems. However, the impact of not investing in our non-filing season systems is being realized, with increasing levels of aged infrastructure resulting in higher levels of instability and downtime in these areas. Our goal to ensure that the hardware, software and other infrastructure components supporting filing season systems were current has been difficult to maintain. With aged infrastructure reaching unacceptable levels, the IRS identified aging infrastructure as the top enterprise risk in FY 2016 and took steps to begin addressing this growing problem. As a result, IRS decreased the estimated replacement cost percentage of aged hardware assets in use from 63% in FY 2017 to 58% the start of FY 2018.

Beyond the existing backlog of aged hardware and software, there is an ongoing need to replace approximately 20% of the IT hardware annually, requiring \$136M in dedicated recurring funding to remain current.

The IRS has completed or is currently working through over 32,000 hardware assets prioritized through the Sustaining Infrastructure program that involves servers, network hardware (Ex. switches, routers, automated call distributors) and IRS employee end user equipment (Ex. laptops, printers).

Walorski

The Return Review Program, or RRP, was designed to replace a legacy fraud detection system from the 1990s, but it came in hundreds of millions of dollars over original estimates and years behind schedule. My concern is that after spending over \$300 million and seven years on the RRP, there doesn't seem to have been an accompanying investment in analysis. As I understand it, IRS analysts are still using a program called Discoverer to analyze potential fraud cases flagged by RRP.

1. Is that correct?

RRP has been in operation since Filing Season (FS) 2015, and continues to perform in Filing Season 2018 as the Government's primary line of defense against the perpetration of tax refund identity theft, fraud and non-compliance. RRP is an integral part of the tax system pipeline and uses state-of-the-art analytics tools to prevent the loss of billions of dollars of revenue by identifying fraudulent tax refund cases and preventing related refunds from being issued. Since the start of FS 2015, RRP has protected over \$10.29 billion in total confirmed revenue, with a Return on Investment (ROI) of more than 1,572%. In FS 2018 (as of March 8, 2018), RRP has systemically flagged approximately 1.3 million potentially fraudulent tax refund returns, with revenue protected figures not available at this time as it normally takes about 120 days to confirm fraud. In FS 2017, RRP systematically selected approximately 1.1 million potential tax refund returns and protected approximately \$4.39 billion in total confirmed revenue. RRP has increased Identity Theft detection by 96% between 2015 and 2016, which has helped decrease Identity Theft victims by over 60% since 2015.

Oracle Discoverer is an IRS Enterprise approved COTS software tool that provides users with standard reports, ad-hoc reports and manual research (i.e., querying) capabilities. Yes, Oracle Discoverer is one of many software tools that the RRP leverages to identify fraud. Leveraging Discoverer, analysts have an ability to manually flag potential fraud cases. In FS 2017, analysts selected 194,418 potential tax refund returns and protected \$323 million in total confirmed revenue.

2. If yes, how old is Discoverer?

IRS analysts have leveraged Oracle Discoverer since 2009. Currently, there are approximately 275 active users using the software tool to analyze the RRP data of potential fraud.

3. Is it true that analysts need to run complex queries on Discoverer overnight in order to prevent the whole system from crashing?

No, it is not true that analysts need to run complex queries overnight in order to prevent the whole system from crashing. Analysts do run complex queries on Discoverer, sometimes on a 24x7 basis, due to just-in-time analytics needs (i.e., to support a time-critical investigation) which may take longer to execute depending on the complexity.

The whole fraud detection system is designed to be composed of both systemic and manual selection. Analysts use Discoverer to manually identify potential Identity Theft cases by running both simple and complex queries. Analysts use Discoverer with read-only access to a separate reporting database environment, which is synchronized nightly with the production database environment. This is a common strategy to ensure that production processing is not impacted by reporting processing

4. How does this lag affect the ability to update RRP filters?

There is no lag that affects RRP's ability to update models, rules, clusters and filters. RRP employs the Cross Industry Standard Process for Data Mining (CRISP-DM) methodology for all its modeling and data mining activities to ensure business involvement in each stage of analytic development. IT collaborates with our business partners on a regular basis to identify new and evolving fraud patterns, to evaluate performance of existing models and to discuss changes for the next Filing Season. Recommended changes to RRP Analytics (models, rules, clusters and filters) follow an evaluation and change management process, and are deployed during periodic maintenance releases.

5. Is there a plan to retire Discoverer? If so, what is the timeline?

IRS is working to determine processes and tools that will allow us to retire legacy components such as Oracle Discoverer. RRP's most recent Releases (2.1 and 2.2) deployed to production in August 2017 and November 2017 respectively, provided the business with additional standard reports and ad-hoc reporting capability, but these do not provide all the manual research capabilities required. There is currently no timeline for Discoverer retirement; however, we continue to work diligently with the business and IT delivery partners to identify solutions that will offer the required capabilities securely and cost-effectively. IRS is working on defining an appropriate timeline and approach to retire the remaining capabilities of the Discoverer tool.

6. With the recent Equifax hack, what is the IRS doing to combat what will likely be more sophisticated fraud attempts?

Refund fraud caused by identity theft (IDT) is one of the biggest challenges facing the IRS today, and the harm it inflicts on innocent taxpayers is a problem we take very seriously. The IRS has a comprehensive strategy focusing on preventing refund fraud, investigating these crimes, and assisting taxpayers victimized by tax-related IDT. Through the Security Summit, an unprecedented partnership between the IRS, the software industry, and the states, we continue a unified battle against IDT and work on collaborative solutions to combat stolen IDT refund fraud. IRS data shows significant improvements as fewer IDT returns entered the tax system, fewer fraudulent refunds were issued and fewer taxpayers were reporting themselves as victims of identity theft.

As identity thieves continue to become more sophisticated, the IRS has tightened its security in response to the increased threat. We are taking steps to make it harder for identity thieves to successfully masquerade as taxpayers and file fraudulent refund claims on behalf of these taxpayers. The IRS and partners recognize that large data breaches of personally identifiable information (PII) is a difficult and frustrating situation for the victims and financial ecosystem. A large-scale data breach such as Equifax, and many others, is a reminder of the value of data for fraudulent purposes and identity theft. Over the last several years, the IRS IDT fraud filtering processes remain effective even in situations of large losses of PII.

IRS uses several robust tools to assist in combatting tax-related IDT and fraud. This includes tools that are specific to addressing taxpayers who have been victims of a data loss of federal tax information (FTI). Because the data losses involving federal tax related data can be used to file returns that appear to be coming from the true taxpayer, IRS has implemented measures to address this. IRS's existing models and filters have been updated to address the level of sophistication used to file these fraudulent returns. We have implemented the use of Dynamic Selection Lists that allow IRS to monitor specific taxpayer accounts who have been victims of an FTI data breach when the data compromised would have a direct impact on federal tax administration. This allows the IRS to more effectively identify these suspicious returns and results in better protection for taxpayers' federal tax accounts and increased revenue protection.

In addition, there are multiple points in the processing life cycle to identify, prevent and assist possible IDT victims: pre-filing, at-filing, and post-filing.

To prevent IDT returns from even coming in the door (pre-filing), we have worked with tax software providers to improve the procedures that new and returning customers must use to identify themselves in order to minimize the chance that the taxpayer's software account can be taken over by identity thieves. This additional security is one of the most visible signs of increased protection to taxpayers because they will notice password requirements and other website security features. In addition, we have implemented a variety of mechanisms to prevent criminals from using a deceased individual's identity information to perpetrate fraud. We routinely lock the accounts of deceased taxpayers and have locked more than 30 million accounts so far.

At-filing, our IDT and fraud detection systems contain complex models and filters developed from historical and newly emerging known fraud characteristics. Address and bank account changes as well as historical taxpayer filing data are characteristics that are used in conjunction with other filters to identify potentially fraudulent/IDT returns. When returns are selected by a filter, the refunds are frozen until additional reviews verify if the refunds are legitimate.

7. How many IRS employees have the ability to sign a \$7 million contract? Please provide a breakdown of which employees can sign which type of contracts.

Currently, there are 78 IRS employees with warrant authority to sign a \$7M contract. In addition, there are 28 other IRS employees with warrant authority to sign contracts that are less than \$7M. In order to obtain warrant authority, IRS employees must satisfy federal and agency-specific training, education, and experience requirements. The below table shows a breakdown of number of employees and warrant limits.

	Warrant Levels										
	\$100 M+	\$100M	\$25M	\$20M	\$10M	\$5M	\$1M	\$500K	\$150K	\$25K	\$15K
Contracting Officer Quantity	63	2	3	1	9	2	12	2	11	0	1

Bishop

1. I understand that the IRS has identified the cost of consolidating case management systems through an internal process. I believe at the hearing you said \$84 million annually for the next five years, to do it internally. Have you identified the cost of using a commercial product or contracting with a data services company to utilize its expertise, for the purpose of consolidating the various case management systems?

First, the \$84 million annually for the next five years was attributable to CADE 2 and not ECM. The IRS is developing a draft Request for Quotations (RFQ) for ECM that is scheduled for issuance in early 2018, which will allow the Service to choose vendors for challenge-based scenarios known as a First Article Test in the industry. The First Article Test will provide limited funding to a small number of vendors to install their product in the IRS IT ecosystem and allow the IRS hands-on access to technical and business capabilities. This will help ensure that the IRS selects the best possible product(s) to do the job based on utilization within the IRS environment. Following the First Article Test, the IRS will then select one or more commercial off the shelf (COTS) products to license to resume development of an enterprise-wide case management system in late 2018 or early 2019. Actual costs of this solution are unknown at this time, but would include any licensing, development, testing, implementation and ongoing operations/maintenance costs. The IRS is actively considering a COTS product or products to consolidate the case management systems currently in use.

2. When did the IRS begin using the Lead Case Analysis (LCA) system? How many times has it been utilized by a case worker in the criminal division each filing season since its acquisition? And how many times has Electronic Fraud Detection System (EFDS) been used by that same population of case workers?

IRS Criminal Investigation (CI) deployed LCA in 2014. LCA is utilized in combination with EFDS daily by CI analysts performing research, developing schemes, identifying emerging fraud and supporting ongoing refund crimes compliance investigations. Since that initial 2014 deployment, LCA's use has also expanded to other user groups within CI working multiple case types, including all field agents and those with a focus on international, money laundering, and cyber-crimes. The numbers below reflect logins for CI's entire user population, as LCA does not track which users are also EFDS users. CI performs all compliance workload activity within EFDS as it is CI's only workload management system to ensure downstream processing occurs.

<u>LCA accessed by CI</u>			<u>EFDS accessed by CI*</u>	
<u>Calendar Year</u>	<u>Total Logins</u>		<u>Calendar Year</u>	<u>Total Logins</u>
2017 (as of Nov 22)	624,383		2017 (as of Nov 22)	18,789
2016	295,910		2016	20,774
2015	37,924		2015	24,310
2014	4,255		2014	29,614

* qualified by the number of logins not number of sessions

3. In the time since the Criminal Investigations Division has begun using LCA, how many times has the civil division used EFDS to analyze a flagged return? And have they been able to use LCA at all?

Nine users in IRS business operating divisions (BODs) other than CI were granted use of LCA. They were able to access daily; however, they only accessed LCA periodically.

The Wage and Investment (W&I) BOD uses EFDS daily as their primary inventory workload management tool to take action on their potential fraudulent inventory and uses Discoverer and Business Objects tools to conduct primary analysis and research on returns and identifying emerging fraud.

IRS requires a real-time system in support of revenue protection and detecting emerging fraud trends. A real-time system is necessary in order to prevent returns from posting and refunds from generating. The functionality of LCA meets most of CI's needs but the data is only updated weekly unlike EFDS which is updated daily; data from LCA does not flow back to EFDS or RRP.

<u>LCA accessed by BODs other than CI</u>			<u>EFDS accessed by Civil BODs</u>	
<u>Calendar Year</u>	<u>Total Logins</u>		<u>Calendar Year</u>	<u>Total Logins</u>
2017 (as of Nov 22)	19		2017 (as of Nov 22)	70,683
2016	14		2016	198,062
2015 (Sept-Dec)	3		2015	346,108
2014	N/A		2014	616,558

4. If civil division case workers have not had access to LCA, why can case workers in the criminal division use it?

CI purchased the commercially available off-the-shelf product as a platform to access multiple datasets at a single access point to support their investigative research needs. IRS IT approved its use for CI only, and the software is not integrated into the workflow business case selection, treatment and management processes in EFDS. In order to be effective for non-CI users, additional capabilities/modules would need to be added to the software.

**Questions for the Record for Mr. David Kautter
Assistant Secretary for Tax Policy, Department of the Treasury
Acting Commissioner, Internal Revenue Service**

**Submitted by Rep. Mark Meadows
Chairman, Subcommittee on Government Operations
House Committee on Oversight and Government Reform**

Since the Patient Protection and Affordable Care Act (ACA) was enacted, the Internal Revenue Service (IRS) had accepted so-called “silent returns,” filings in which a taxpayer does not indicate whether they have essential minimum coverage as required by the ACA, qualify for an exemption, or have paid a tax penalty known as the “shared responsibility payment.”¹

According to a report issued by the Treasury Inspector General for Tax Administration (TIGTA) on January 31, 2018, beginning with the 2017 filing season the IRS had planned to reject silent returns and notify taxpayers that they needed to report having minimum essential coverage, claim an exemption, or pay the penalty; taxpayers that did not respond would be assessed the penalty.²

In January 2017, President Donald J. Trump issued Executive Order 13,765, in which agencies were instructed to, “take all actions consistent with law to minimize the unwarranted economic and regulatory burdens of the [Affordable Care] Act.”³ In February 2017, in response to this Executive Order, IRS announced it would continue to accept silent returns, as had been the agency’s practice, citing the executive order’s directive.⁴

Throughout the 2017 filing season, the IRS followed this policy, consistent with the President’s directive to, “exercise authority and discretion to reduce any potential burden on the taxpayer.”⁵ However, in October 2017, the IRS announced for Tax Year 2017, “the IRS will not consider a return complete and accurate if the taxpayer does not report full-year coverage, claim a coverage exemption, or report a shared responsibility payment on the tax return.”⁶ The IRS further informed the public that, “to avoid refund and processing delays when filing 2017 tax returns in 2018, taxpayers should indicate whether they and everyone on their return had coverage, qualified for an exemption from the coverage requirement or are making an individual shared responsibility payment.”⁷

¹ TAXPAYER ADVOCATE SERV., OBJECTIVES REPORT TO CONGRESS, VOLUME 1, FY 2018, 92 – 97 (2018), https://taxpayeradvocate.irs.gov/Media/Default/Documents/2018-JRC/JRC18_Volume1_AOF_11.pdf.

² TREASURY INSPECTOR GEN. FOR TAX ADMIN., NO. 2018-40-012, RESULTS OF THE 2017 FILING SEASON (2018), <https://www.treasury.gov/tigta/auditreports/2018reports/201840012fr.pdf>; Katie Keith, *Treasury Inspector General Releases New Report On ACA Tax Filings For 2016*, HEALTH AFFAIRS, February 11, 2018, <https://www.healthaffairs.org/doi/10.1377/hblog20180210.886736/full/>.

³ Exec. Order No. 13765, 82 C.F.R. 8351 (2017).

⁴ Kelly Phillips Erb, *IRS Softens on Obamacare Reporting Requirements After Trump Executive Order*, FORBES, Feb. 16, 2017, <https://www.forbes.com/sites/kellyphillipserb/2017/02/16/irs-softens-on-obamacare-reporting-requirements-after-trump-executive-order/#503ebe90a3cb>.

⁵ Michael Hiltzik, *Trump’s IRS stages a stealth attack on Obamacare*, LOS ANGELES TIMES, February 15, 2017, <http://www.latimes.com/business/hiltzik/la-fi-hiltzik-irs-obamacare-20170215-story.html>.

⁶ *IRS Individual Shared Responsibility Provision*, INTERNAL REVENUE SERV., <https://www.irs.gov/affordable-care-act/individuals-and-families/individual-shared-responsibility-provision>.

⁷ *Id.*

The IRS's stated rationale for its change in policy seemingly lacks foundation in a change of circumstances. In justifying the rejection of silent returns, the IRS indicated the shift reflected, "the requirements of the ACA and the IRS's obligation to administer the health care law."⁸ However, the IRS's obligation to faithfully administer the law is the same now as it was when the IRS accepted silent returns, as is the IRS's obligation to, consistently with the law, minimize the unwarranted economic and regulatory burdens of the ACA. This is particularly so in light of the fact that the individual mandate penalties have been zeroed out by the recently passed tax bill. The IRS's collection of information for a now-toothless mandate can only be construed as a burden, seemingly within the scope of the President's executive order.

Regardless of the rationale, the IRS's recent interpretation of how it must administer the ACA appears to be an agency's, "statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy." Administratively, the IRS has warned paper tax returns "may be suspended pending the receipt of additional information and any refunds may be delayed."⁹ As such, the IRS' new posture on silent returns may be a rule for purposes of 5 U.S.C. §§801- 808, the Congressional Review Act. Furthermore, the IRS's statement on silent returns does not appear to fit within the CRA's three exemptions.

1. Do you consider the IRS's recent policy change on so-called silent returns to constitute an official statement of general or particular applicability and was designed to implement, interpret, or prescribe law or policy?

Response:

The announcement that for the 2018 tax filing season IRS will not accept silent returns filed electronically is not a rule subject to the Congressional Review Act (CRA) because section 804(3)(C) of the CRA excludes from review "any rule of agency organization, procedure, or practice that does not substantially affect the rights or obligations of non-agency parties." GAO concurred with the IRS position in an opinion dated May 17, 2018.

2. Why did the IRS decided to alter its policy in contravention of the President's executive order?

Response:

Executive Order 13765 (January 20, 2017) directed federal agencies to exercise authority and discretion available to them to reduce potential burden, pending changes to the ACA. Therefore, we made the decision to accept tax year 2016 silent returns based on the belief this was an area in which we had administrative discretion. The determination to accept silent returns did not affect the underlying legal responsibility, but merely the timing of our compliance efforts.

Following the announcement in February 2017 that the IRS would accept silent returns, the National Taxpayer Advocate stated that rejecting silent returns at the time of filing is the least burdensome approach because it alerts the taxpayer and allows for immediate correction. If the

⁸ *Id.*

⁹ Hiltzik, *supra* note 5.

IRS accepts a silent return and later corresponds about it with the taxpayer, the taxpayer may be required to spend time and money months later to try to resolve the problem.

After a review of our process and discussions with the National Taxpayer Advocate, we determined that identifying omissions and requiring taxpayers to provide health coverage information at the point of electronic filing reduces the burden on taxpayers of complying with the law. As supported by the National Taxpayer Advocate, this approach reduces the amount of time and money that taxpayers would have to spend months later demonstrating their compliance with the law. Consequently, we resumed our plans for tax year 2017 to reject silent returns filed electronically. We are corresponding with taxpayers to address the silent returns filed on paper. The individual mandate penalty was repealed for tax years 2019 and beyond, accordingly, IRS will be reconsidering this policy for tax years after 2019.

3. Under whose direction did this change in agency policy take place and when?

Response:

The decision to not accept silent returns was made in February 2017 in consultation with IRS senior executive leaders and the IRS Chief Counsel.

4. Will the agency submit its new policy to Congress in accordance with the Congressional Review Act?

Response:

As GAO concurred, the announcement that the IRS will not accept silent returns is exempt from the CRA because it is a rule of agency procedure or practice that does not substantially affect taxpayers' rights or obligations. Accordingly, we do not plan to submit it to Congress.

Additional questions:

- 1. At our hearing, you committed to provide the Committee within 90 days from April 17, 2018, a report detailing how the IRS plans to reduce the rate of false positives with respect to fraudulent reports under fifty percent. What is the status of this report?**

Response:

We are working with the Taxpayer Advocate and look forward to providing you the report.

- 2. In 2018, it was reported that approximately 33 million calls have been made to the IRS, with approximately 6.4 million having been answered by a real person or a tax assistant. What is the current number of taxpayer calls that went unanswered? What is the average wait time for taxpayer calls? Is the average wait time faced by taxpayers calling the IRS in fact six minutes as you testified at our hearing on April 17th?**

Response:

As I mentioned at the hearing, we received 33 million customer service calls between January 1 and March 17, 2018. This number represents the calls to the IRS Customer Service Representatives (CSR) line from tax practitioners, individuals and business owners seeking assistance regarding their accounts or general tax law questions. The wait time this filing season for these calls was less than 6 minutes (as of March 17, 2018). In comparison, the average speed of answer was 9 minutes in 2016, and 7 minutes in 2017 during this same time period.

The following is a breakdown of how the 33 million calls were handled (numbers are rounded): about 6.4 million were answered by CSRs, 6 million came in after our hours of operation (with 2.3 million of those calls answered through self-service automation), 7 million hung up or disconnected (when the system reached capacity), 5 million transferred to non-taxpayer service lines (e.g., Automated Collection System), and 9.2 million were answered in automation.

Taxpayers that speak to a CSR are receiving accurate advice. This fiscal year, CSRs answering tax law calls are achieving a 95 percent accuracy rate, and taxpayer account calls are achieving a 96 percent accuracy rate.

Calls to CSRs are a subset of all calls that the IRS received on various IRS telephone lines. Performance results for other types of calls, for example calls about compliance activity or balance due are reported separately. Taxpayers calling the IRS toll-free customer service line first navigate through automated menus informing them how to get their questions answered by selecting from menu options of frequently asked topics such as refund status, transcripts, tax reform law, individual and business tax topics, and how to find information on IRS.gov. Many taxpayers have their questions answered through automated responses or choose the option to go to IRS.gov.

3. **At our hearing, you committed to provide the Committee within 90 days from April 17, 2018, a report detailing the results of your top ten senior officials interacting with front line staff to gauge their answers to common tax questions and the efficacy of their service. What is the status of this report?**

Response:

We are developing a response and look forward to providing you the results.

Submitted by Rep. Jim Jordan
Chairman, Subcommittee on Healthcare, Benefits, and Administrative Rules
House Committee on Oversight and Government Reform

Non-profit entities are generally required to file tax returns with the IRS. These returns must disclose information like gross income, receipts, disbursements, and “such other information for the purpose of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe.”¹⁰ This information is filed on a “Return of Organization Exempt From Income Tax,” also known as a Form 990. Non-profit entities are also generally required to

¹⁰ 26 U.S.C. § 6033(a)(1).

disclose the names and addresses of all substantial contributors.¹¹ This disclosure is made through a Schedule B, attached to Form 990.

1. Are you aware that the previous Commissioner of the IRS and the head of the tax-exempt division made public statements in 2015 questioning the need for Schedule B forms and indicated that the IRS could not guarantee the confidentiality of the information being provided?

Response: Yes.

2. Are you aware of abuses by the prior administration with regard to IRS targeting of 501(c)(3) and 501(c)(4) organizations that started in 2010 and was revealed in May 2013 by Lois Lerner, then the IRS's Director of the Exempt Organizations Unit?

Response:

I am aware of past practices at the IRS that led to the issuance in May 2013 of TIGTA's report entitled "Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review." I am also aware of the ensuing investigations by Congress, DOJ, the FBI, and TIGTA. The IRS agreed with and implemented all of the recommendations made by TIGTA in its May 2013 report. Since the issuance of the report, the IRS and its leadership team have been, and remain, absolutely committed to avoiding selection and further review of potential political cases based on names and policy positions.

3. And are you further aware that this targeting illegally prevented many of these groups from exercising their First Amendment rights during that time period?

Response:

I am aware of the past practices that led to the issuance of the May 2013 TIGTA report and the allegations that those practices prevented them from exercising their First Amendment rights.

4. Are you aware that during this time period, among other forms of harassment and targeting, some state Attorneys General, particularly in California and New York, demanded that 501(c)(3) organizations turn over their Schedule B (donor lists) or face fines or lose the ability to operate in these states?

Response: Yes.

5. Are you aware that Internal Revenue Code requires 501(c)(3) organizations to provide a Schedule B to the IRS?

Response: Yes, on July 16, 2018, after careful review, the IRS and Department of the Treasury released Revenue Procedure 2018-38 limiting the requirement to file a Schedule B to organizations described in Section 501(c)(3) or Section 527 of the Internal Revenue Code.

6. Are you aware that there is no federal statute that requires 501(c)(4) or 501(c)(6) organizations to provide a Schedule B to the IRS?

Response: Yes.

¹¹ See 26 C.F.R. § 1.6033-2(a)(1); 26 C.F.R. § 1.6033-2(a)(2)(ii)(f) (The IRS defines a "substantial donor" through regulation as a person, "who contributed, bequeathed, or devised \$5,000 or more (in money or other property) during the taxable year.")

7. **Are you aware that the requirement that 501(c)(4) and 501(c)(6) organizations provide Schedule B information to the IRS comes from a tax regulation?**

Response: Yes.

8. **Are you aware that some of these organizations also are and have been the subject of harassment and threats regarding their donor lists and their exercise of their First Amendment rights of free speech and free association?**

Response: Yes.

9. **And are you aware that the IRS or Treasury could commence a rulemaking proceeding and eliminate those requirements?**

Response: Yes.

10. **Given all of the above, including the last administration's statements that they don't need or want Schedule B documents and can't ensure confidentiality, would you support eliminating the requirements for schedule B forms to be submitted by 501(c)(3), 501(c)(4), and 501(c)(6) organizations?**

Response: Yes. However, organizations exempt from tax under Section 501(c)(3) of the Internal Revenue Code (Code), however, are required to report to the IRS names and addresses of all substantial contributors under Section 6033(b)(5) of the Code. Eliminating this requirement would require a statutory change. The Department is in favor of eliminating the requirement so that all other organizations described in Section 501(c) would no longer be required to submit the names and addresses of their donors. And on July 16, 2018, the Department and the IRS announced that the IRS will no longer require certain tax-exempt organizations to file personally-identifiable information about their donors as part of their annual return. The revenue procedure does not affect the statutory reporting requirements that apply to tax-exempt groups organized under section 501(c)(3) or section 527, but it relieves other tax-exempt organizations of an unnecessary reporting requirement that was previously added by the IRS.

The Office of Personnel Management reported that there are approximately 250,000 Federal employees whose salaries are now redacted, as compared to approximately 3,400 in the prior year. A number of redactions relate to IRS employees.

1. **How many employees of the IRS were among those whose salaries were redacted?**

Response:

The Office of Personnel Management (OPM) has a [Data Release Policy](#) governing the release of information concerning Federal civilian employees – including specific agreements with various federal agencies. Among other items, OPM has identified various organizational positions as “sensitive” and protected from disclosure to the public. For the IRS, there are nine occupations deemed “sensitive” and subject to redaction on public information listings:

Occupation	Title	On-roll as of 3/31/18
0083	Police	9
0512	Internal Revenue Agent	9,197
0930	Hearings and Appeals	813
1169	Internal Revenue Officer	3,189
1171	Appraising (Property Appraisal and Liquidation Specialist)	72
1801	General Inspection, Investigation, Enforcement and Compliance	40
1802	Compliance Inspection and Support	205
1805	Investigative Analysis	171
1811	Criminal Investigation	2,081
Total		15,777

We have been informed that OPM recently implemented redactions to the adjusted base salaries of sensitive occupation employees in order to more effectively protect duty station locations. Base salaries remain disclosable for that group because they do not include the locality pay component which reveals duty station location. Therefore, depending on the type of request OPM receives, the adjusted base salary component for up to 15,777 IRS employees (out of a total of 81,826) could be redacted because OPM's March 2017 Data Release Policy deems those employees' positions sensitive and provides that the employees' names and duty station location information will be withheld. Again, base salaries for this group of 15,777 IRS employees may still be released under OPM's Data Release Policy. OPM is finalizing updates to its Data Release Policy in order to provide greater transparency; however, any further changes will not further impact how salaries are reported for this population

In 2012, the Treasury Inspector General for Tax Administration (TIGTA) reported shortcomings at the IRS in catching Individual Taxpayer Information Number (ITIN) fraud, and that in one case nearly 24,000 ITINs filed returns utilizing one address, resulting in the remission of tax refunds of more than \$46 million.¹² In April of 2017, during a Senate Homeland Security and Governmental Affairs hearing,¹³ Mr. George stated the IRS has not fixed this problem.

- 1. Has the IRS implemented a policy to recognize and prevent an abnormal number of returns being sent to the same address? If so, what are the details of that policy? If not, when will the IRS address this critical failing in fraud prevention?**

Response:

During an April 26, 2017, Senate Homeland Security and Government Affairs hearing, the TIGTA Inspector General, the Honorable J. Russell George, corrected his prior testimony that the IRS had not fixed the problem. He acknowledged that, as of April 2017, the IRS is making

¹² See TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, 2012-42-081, SUBSTANTIAL CHANGES ARE NEEDED TO THE INDIVIDUAL TAXPAYER IDENTIFICATION NUMBER PROGRAM TO DETECT FRAUDULENT APPLICATIONS (2012), <https://www.treasury.gov/tigta/auditreports/2012reports/201242081fr.pdf>.

¹³ *Duplication, Waste, and Fraud in Federal Programs: Hearing Before the Senate Committee on Homeland Security and Governmental Affairs*, 115th Cong. (2017).

progress and deserves credit for making changes that enabled the IRS to stop over 92,000 refunds, which is almost half a billion dollars.

The IRS now uses the Return Review Program to detect patterns and relationships to identify clusters of returns that share traits predictive of refund fraud schemes and non-compliance. One use of clustering is the identification of groups of returns that share the same address, ZIP code, and bank routing number, among other traits. This allows IRS to prevent potentially fraudulent refunds from being sent to the same address.

To deter refund fraud and identity theft, in 2015 we began limiting the number of direct deposit refunds into a single bank account to three. Any additional refunds are automatically converted to a paper check and mailed to the address of record.

In addition, we have made changes to how we process Form W-7, Application for IRS Individual Taxpayer Identification Number. In late 2012, we began generating a monthly report to identify W-7 ITIN applications with the same mailing address. We select a sample and evaluate those W-7 applications. Alerts are then issued to notify ITIN tax examiners of potential questionable W-7 applications. Data collected from these W-7 applications are submitted to Criminal Investigation as potential fraud.

The Protecting Americans from Tax Hikes (PATH) Act, enacted in December 2015, mandated the expiration of ITINs not listed on a federal tax return for three consecutive years and ITINs issued from 1996 to 2012, require renewal for any still in use and issued within this time. In January 2017, we deactivated all ITINs not used on a tax return for three consecutive years and, with a phased approach, we started to deactivate ITINs issued before 2013. Through January 2018, 14.7 million ITINs have been deactivated, of which IRS has received nearly 672,000 renewal applications (October 2016 through March 31, 2018). The PATH Act also provided IRS math error authority for ITINs, enabling us to prevent benefits related to expired or revoked ITINs.

At the April 2017 hearing before the Senate Committee on Homeland Security and Governmental Affairs, Mr. George also stated that Congress had passed legislation to require the use of a Social Security Number or green card number to receive the Earned Income Tax Credit (EITC). However, for the Additional Child Tax Credit (ACTC), Mr. George testified that the IRS disagrees with TIGTA that federal law requires a Social Security Number or green card number.

- 1. Please explain in detail the IRS's position that individuals may receive the ACTC without providing a Social Security Number or other identifying number.**

Response:

Before 2018, the IRS disagreed with TIGTA's interpretation that Section 24(e) of the Code required an SSN for the taxpayer and qualifying child because the language of Section 24 of the Code dealing with identification requirements for the CTC/ACTC was broader than the language of Section 32 of the Code about the earned income credit. Prior to 2018, Section 24 of the Code only required that a taxpayer and qualifying child have a taxpayer identification number, but section 32 of the Code requires a taxpayer, a taxpayer's spouse, and a qualifying child to have a specific type of SSN. See IRC § 32(m).

However, Section 11022 of the Tax Cuts and Jobs Act modified these rules for tax years 2018 through 2025. For these tax years, taxpayers may claim the full CTC/ACTC for a qualifying child only if the child has an SSN that is valid for work. See IRC § 24(h)(7). The taxpayer (generally, a parent) may continue to claim the CTC/ACTC with either an SSN or an ITIN, but only if the qualifying child for whom the credit is claimed has a valid SSN.

Financial Services and General Government Subcommittee
Hearing on the Internal Revenue Service
for the Honorable David J. Kautter, Acting Commissioner

Responses to Questions for the Record Submitted by Congressman Graves

IT Modernization

The IRS is in the process of replacing the 1960s Individual Master File system, which is the core tax processing system for over 250 million individual taxpayers, with the Customer Account Data Engine 2 or CADE 2.

Since the success of CADE 2 is so critical to IRS's modernization efforts, please explain why the conversion to CADE 2 is taking so long and when does the IRS anticipate that CADE 2 will be fully operational? What is needed to expedite CADE 2's completion? What are the potential risks to taxpayers and the IRS with the conversion taking so long?

Since the Individual Master File dates back to the 1960s and includes all individual income tax filers, there is concern that its functionality and impact on the current and future filing seasons is putting taxpayer data at risk as well as hindering the tax filing process.

Question: Why is the conversion to CADE 2 taking so long?

Response:

Three primary factors related to technology and human resources have limited the pace of CADE 2 development:

1. **Complexity of Tax Law Business Rules:** Since the Individual Master File (IMF) was built 56 years ago, additions have been made to the base code annually to implement changes to the tax law. As a result, the base code now reflects every tax law change made since 1962 and includes embedded business logic that only a small number of the IRS's personnel understand. As part of CADE 2, we are taking an important step of 'harvesting' the logic. This is done by examining both the code and the documentation to extract business rules and is necessary to separate the logic from the code. This simplifies both the modernization effort and subsequent maintenance. If this is not done properly, the IRS will expose itself to higher than acceptable levels of risk to the entire tax processing system.
2. **Downstream System Dependencies:** Limitations of Assembly Language Code (ALC) or of the underlying data record layout have caused the IRS to continuously add new systems to its IT environment over the past six decades to deliver new business capabilities. Because the IMF was the first IRS taxpayer database system, most of the ancillary systems within the IRS are now dependent upon it. As an analogy, one could think of the IMF as the cerebral cortex of the IRS tax systems, with hundreds of

downstream systems serving as the nervous system – the IMF sends and receives data constantly throughout the system. Like the IMF, these systems are generally written in outdated coding formats so both the systems and interfaces to them face similar risks as the IMF. This means that we must take extreme care with modernization activities to understand and then deal with the ripple effects of any one change to the IMF. If the IRS does not dedicate the time needed to understand dependencies and regression test changes thoroughly, unintended consequences could negatively affect many of our critical business processes, including refunds, financial statements, customer service, and compliance. This requires a meticulous and robust test strategy and an extensive period of parallel validation.

3. **Shortage of IMF and ALC Subject Matter Experts (SMEs):** The IMF contains over 500,000 lines of legacy ALC with unique coding conventions and complexities that simply do not exist in modern programming languages. Our ALC and IMF Subject Matter Experts (SMEs) possess the deep understanding of how the IMF works that is critical to modernizing it. SMEs are retiring every day and the ones remaining are at full capacity, tasked with multiple responsibilities: 1) maintaining the IMF, 2) analyzing annual tax law changes and updating the system to implement those changes, including tax reform (by far the largest change to tax processing in three decades), and 3) providing support to the modernization effort. We are very proud of our IMF development team and the heroics they go through every year. However, training someone to proficiency takes a minimum of 3 to 5 years, further limiting our ability to maintain a workforce to support legacy IMF. Hiring freezes, competition for individuals with programming experience, changes in the tax code, and the expiration of the IRS's streamlined critical pay authority are all contributing factors hampering our ability to hire new SMEs. This has resulted in an increased reliance on contractor support, which increases costs, outsources the most critical piece of IRS business systems, and diminishes the pipeline of replacement government resources. However, with the direct hire authority we received from OPM, the IRS believes it can address its workforce challenges.

Question: When does the IRS anticipate that CADE 2 will be fully operational?

Response:

While the IRS has made significant progress toward modernizing the IMF, it is a huge undertaking. To limit risk and demonstrate incremental progress toward modernization, the IRS is delivering CADE 2 through three phases called Transition States. The first Transition State (TS1), successfully built out, stabilized, and migrated all IMF data to the CADE 2 relational database and was completed in 2014. The second Transition State (TS2) is currently in progress, with a target completion date of 2021-2022. CADE 2 will be fully operational once the IRS completes Transition State 3 (also called Target State). There is not yet a target completion date for Transition State 3. The timeline for Target State will be established and approved prior to the conclusion of TS2. Because of the complexities of the modernization, IRS is focusing on the most critical part of modernizing the IMF – the core processing components. IRS has recently completed an update of the CADE 2 Solution Architecture, including a definition of Target State and it will be the basis for a program planning effort scheduled to start in Q1 2019. This effort

will establish the full CADE 2 program roadmap encompassing all remaining transition states and the Target State. That roadmap will determine the scope of the remaining transition state(s) and a completion date. IRS is monitoring project schedules and resources closely and pursuing additional hiring authority in an effort to mitigate these risks, deliver TS2 on schedule, and begin work on the final state.

Transition State 1 – *Completed in 2014*: TS1 successfully built out, stabilized, and migrated all IMF data to the CADE 2 relational database. Additionally, TS1 enabled the use of CADE 2 data for online access and extracts to numerous downstream IRS systems, supporting customer service and compliance. The IRS shifted tax processing from weekly to daily processing, resulting in faster refunds, notices, and improved taxpayer service by providing more current taxpayer information across the IRS. By shifting all individual tax processing from a weekly cycle to daily cycles, all transactions, including refunds, are processed on average 5 days faster. The faster processing provides posted taxpayer data to internal operations within 24 to 48 hours to support accounts management and customer service. Posted refunds designated for direct deposit are in the taxpayer's bank account within 4 business days and paper refunds are mailed within 6 business days.

Transition State 2 – *In progress, Target Completion 2021-2022*: TS2 has been focused on three strategic goals:

1. Reengineering the IMF by applying modernized programming language.
2. Establishing the CADE 2 database as the Authoritative Data Source (ADS) for financial and legal purposes.
3. Addressing the Unpaid Assessment Financial Material Weakness (FMW) for individual taxpayer accounts.

The program is now focused on reengineering the IMF core components by applying modernized programming language. The other two goals (FMW and ADS) are currently on pause to ensure scarce resources can focus on the core IMF modernization. The pause is a result of:

- budget reductions,
- years of hiring constraints,
- limited IMF subject matter experts (SMEs),
- contention for people, specialized skillsets and expertise among other high priority initiatives, and
- an increased understanding of CADE 2 developmental needs.

The projects that were paused are detailed in the Appendix and will be addressed in the program planning update in FY 2019.

The IRS is now reengineering the most complex areas of the IMF where the majority of the tax law is embedded. By leveraging the initial translated code and significant logic harvesting that has been the primary focus thus far in Transition State 2, the IRS is forward-engineering the code into a modern java architecture. Because TS2 encompasses the goal of modernizing the core IMF processing components, it is the most complex transition state.

Key accomplishments delivered include:

- Deployed database conversion capability that now allows the IRS to retain expanded taxpayer history for approximately two billion taxpayer records, improving service and enhancing compliance.
- Implemented common code across IRS systems to enable consistent and accurate penalty and interest calculations on financial statements, resulting in no projectable errors identified in the fiscal year 2016 Government Accountability Office annual audit.
- Modernized one of the IMF's most complex set of financial reports, Financial Recap Reports, and deployed it into parallel production to allow for business validation of CADE 2 reports against IMF results.

Transition State 3/Target State – *Not started, Target Completion TBD*: The final transition state will modernize the remaining IMF components, including IMF pre-processing (validation of tax transactions) and post-processing applications (distribution of taxpayer information to other IRS and external systems). Unlike the core components of the IMF addressed in TS2 (which contain all the tax law changes since 1962 and the associated business logic), IMF pre- and post-processing are possible candidates for deploying commercial off-the-shelf (COTS) products or tools. These could be used to perform the validation and distribution services required to replace the remaining components of IMF processing. Prior to completion of TS2, we will conduct a program planning effort to establish the timeline for TS3/Target State by leveraging the Solution Architecture. This program planning exercise is expected to start in the first quarter of FY19.

Question: What is needed to expedite CADE 2's completion?

Response:

The effort to finalize and document the CADE 2 Target State Solution Architecture is complete. The Solution Architecture provides a better view of the full scope of work required to modernize all components of the IMF that remain after the completion of TS2. There are three primary aspects to expediting CADE 2's completion:

- **Consistent and Adequate Funding:** The IRS needs dedicated and consistent funding to continue to progress on core components and will need to allocate funding in the future to reinitiate the implementation of the FMW and ADS projects to achieve the Target State.
- **Availability of IMF SMEs:** As highlighted above, SME availability is a key requirement for IMF modernization. The number of developers who know and understand the antiquated technology and complex tax law business rules is decreasing at an alarming rate. Fifty percent of the current workforce is eligible for retirement this year. SMEs are working at capacity supporting annual tax law changes, including the tax reform bill, and cannot be dedicated to modernization full-time. This slows the speed at which the IRS can deliver CADE 2.
- **Development of a Comprehensive Plan:** The complexity of the IMF requires the IRS to take a methodical approach to modernization, providing time to review all IMF system dependencies and embedded logic in CADE 2. This requires robust testing and periods of

parallel validation before the IRS can confidently retire the legacy IMF while simultaneously minimizing the risk of adversely affecting annual filing season activities.

Question: What are the potential risks to taxpayers and the IRS with the conversion taking so long?

Response:

- While the IMF has successfully supported tax filing for the past 56 years, it has become increasingly difficult to implement annual tax law changes with the decreasing number of SMEs who understand how the system works. To help mitigate this risk in TS2, the IRS has prioritized the most complex aspect of CADE 2: modernizing the core IMF processing components. This strategy will help to simplify the architecture and build knowledge across the broader workforce.
- The IMF's legacy code imposes technical limitations that prevent the IRS from implementing modernized capabilities that customers need. For example, once fully implemented, CADE 2, in conjunction with other modernized applications, will enable new online capabilities. For example, it would allow taxpayers to view their account, and update certain account information directly in real-time. This type of real-time capability is not feasible with ALC code. With ALC code, an update has to go through batch processing and cannot be immediately viewed. Because CADE 2 aggregates all data and will keep track of all transactions on the account, taxpayers will be able to see all their history using IRS web applications, including every transaction that has been posted to their account.

Tax Reform and Taxpayer Service New Hires

Question: If the IRS receives an additional \$77 million to hire 1,000 new customer service employees early in fiscal year 2019, what is the anticipated level of customer service taxpayers can expect during the 2019 filing season?

Response:

Based on anticipated call volume and the requested \$77 million, the IRS will ensure that a sufficient number of CSRs are available to answer taxpayer questions, including those related to the new tax law. In addition, the IRS will answer tax reform tax law questions year-round, not just during filing season. If funded at the same level as FY 2018, and we receive the additional tax reform funding, we plan to deliver an 80% toll-free level of service for the filing season.

Question: What is the IRS's hiring plan for onboarding these new staff?

Response:

We are hiring CSRs this year so we can be ready to answer taxpayer questions including those related to the new tax law. The planned start date for most of these new hires is October 2018.

Because of the time to onboard and train new hires to be ready for filing season, we are hiring the additional employees (along with annual attrition hires) with start dates in October.

Question: Can the IRS guarantee that these 1,000 individuals dedicated to assisting U.S. taxpayers will be trained and ready to provide quality customer service during the 2019 filing season?

Response:

The IRS will ensure that all CSRs and all assistors in our Taxpayer Assistance Centers will be trained and able to provide quality customer service for the 2019 filing season.

Question: Can you guarantee that the IRS will be responsive to our constituents?

Response:

We plan to train all new hires to respond to frequently asked taxpayer questions such as refund status, transcripts requests, individual and business tax topics, and how to find information on IRS.gov. In addition, we will train experienced employees on tax reform and tax law inquiries. We will constantly monitor the service being provided to taxpayers for responsiveness and quality.

Improper Payments

Beginning in FY 2017 the IRS held all refunds for taxpayers claiming the Earned Income Tax Credit (EITC) or the Additional Child Tax Credit (ACTC) until mid-February so that it could perform a systemic verification of wages and other information before issuing refunds.

Question: What is the impact this has had on the 2018 filing season?

Response:

This year, the earlier availability of Form W-2 data enhanced the IRS's defenses against identity theft and refund fraud. The IRS has conducted systemic verification of information reported on taxpayers' returns against previously reported third-party information before issuing refunds. In addition, the IRS is utilizing the earlier-filed Form 1099-MISC for non-employee compensation information as a variable in the filtering process, though not all institutions and employers met the reporting deadline.

In filing season 2018, the IRS held 9.4 million in refunds (with \$46.9 billion of those refunds claiming the Earned Income Tax Credit (EITC) and/or the Additional Child Tax Credit (ACTC)) until February 15, 2018, as required by Section 201(b) of the Protecting Americans from Tax Hikes (PATH) Act of 2015. This represents about 23 percent of the returns received through that time. Unless the return was selected for a pre-refund compliance review in the Integrity Verification Operations, these refunds were released February 15, 2018.

Question: What improvements were implemented over the last filing season to improve the verification process of these credits?

Response:

The IRS implemented new filters leveraging the earlier availability of the information returns and the systemic verification functionality in the Return Review Program. These new filters detect returns with false or incorrectly reported income or withholding for returns with EITC and/or ACTC. Filters also detect returns where the IRS could not verify income or withholding.

Question: Is there any indication that there will be a reduction to the improper payments from the 2017 to 2018 filing season?

Response:

It is too early to determine this with certainty as the IRS is still processing and analyzing data from the 2018 filing season. The earlier availability of third-party data enhanced the IRS's defenses against identity theft and refund fraud. In addition, this filing season, the IRS leveraged both the Return Review Program and the PATH Act refund hold to automate and expand the selection of potentially fraudulent returns. Through February 15, the IRS identified approximately 312,000 PATH Act returns claiming EITC or EITC and ACTC with potential issues with overstated income or withholding. Some employers may submit their information returns after January 31. If the IRS received information to verify return information after holding a refund, the refund was released. Those returns that remained unverified will require an examination.

Because of the complexities in the EITC statute, particularly the eligibility requirements, the IRS has been able to make limited progress in addressing EITC improper payments. Administering EITC represents a significant challenge for the IRS due to the refundable nature of the tax credits, the lack of correctable error authority to adjust erroneous EITC claims, and the absence of a single comprehensive government database or third party reliable and readily available data sources that we can use to confirm all EITC eligibility requirements. We continue to look for new sources of data and new tools to stop refundable credit improper payments. For example, the IRS has expanded the EITC awareness campaign and hosted hundreds of outreach events; developed an EITC return preparer strategy and conducted hundreds of due-diligence visits, assessing penalties where appropriate; improved the EITC preparer's due diligence checklist; developed the EITC Assistant to help taxpayers verify eligibility; increased coordination with industry and state/local tax agencies; and refined the Return Review Program's fraud detection filters. While the PATH Act may be helping to reduce the number of improper payments, it will not come close to eliminating them.

As stated above, we do not have correctable error authority to adjust erroneously claimed EITC. Therefore, we address these errors through audits, which require significant time and resources. We appreciate the authority to accelerate filing dates for information returns. Still, we need additional statutory authority to increase our success rate in preventing EITC fraud and improper EITC payments. The legislative proposals included with the President's fiscal year 2019 Budget would help by giving the IRS the expanded authority to use correctable or math error authority to correct more errors on tax returns, including claimed EITC, before refunds are issued. Additionally, the proposal to increase the IRS's oversight authority over paid tax return preparers would help reduce unscrupulous tax return preparers filing erroneous and fraudulent EITC

returns. The most significant challenge, however, in reducing improper EITC payments is in the design of the statute and the inability of the IRS to validate the eligibility of a taxpayer to receive the credit claimed, e.g., residency requirements and relationship requirements.

Appendix

Release Plan / Project Summaries

CADE 2 TS 2 will be delivered in the following six releases.* Each project supports one of three TS 2 goals: IRE, ADS and FMW.

Release*	Status	TS 2 Goal	Project Name and Summary
1.0	Deployed Q1 2015	FMW	Penalty & Interest – Improves the accuracy of P&I calculations by resolving internal control deficiencies that exist within the common P&I code (FMW 1).
2.0	Deployed Q1 2016	FMW	Pending Payment Transactions – Improve accuracy of financial reports by including pending payment transactions in the unpaid assessment balance. Existing Reports are modified in Release 2.0.
	Deployed Q1 2016	FMW	Penalty & Interest Adjusted Refundable Credit – Corrects Failure to Pay Penalty computations for adjusted refundable credits which resulted in 8 million tax modules with inaccurate computations (FMW 1, 2, 3). Results in changes to the common P&I Code.
	Deployed Q1 2016	ADS	Database Conversion – CADE 2 will begin performing annual maintenance on accounts, eliminating the need to re-initialize the database each year. This allows the CADE 2 database to maintain history tables for auditing and analytical purposes. Database conversion will result in changes to the CADE 2 database and IEAC / daily updates ETL solution components.
	Deployed Q1 2016	ADS	Feed to IPM Phase 1 – Establishes an interface from the CADE 2 Database to the IRS Data Warehouse (IPM); enabling downstream systems to begin pulling CADE 2 data for financial reporting and analytics on taxpayer accounts.
	Deployed Q2 2017	ADS	Financial Recap Reports 2.0/2.1 – CADE 2 Database enhancement to generate three financial reports: Controls Recap, Summary Recap, and Detailed Recap.
3.0	Deployed Q4 2017	ADS	Feed to IPM Phase 2 – Enhance CADE 2 to IPM interface and data model to update the CADE 2 Operational Data Store on a daily basis, improve performance, and enable additional reporting capabilities.
	Deployed Q4 2017	ADS	Data Services Framework - The Data Services Framework is a set of sharable and reusable IRS developed common services used to perform data selection, transformation, and output generation. It establishes the framework to provide the CADE 2 data to downstream systems in legacy and modernized data formats.

Release*	Status	TS 2 Goal	Project Name and Summary
4.0	Deployed Q4 2017	ADS	Financial Recap Reports Performance Enhancements – Expands upon the goals of the FRR Release (R) 2.0/2.1 project by improving the system performance and implementing balance and control between the modern and legacy platforms to ensure that counts and amounts are in concurrence.
	Paused	ADS	CFO Critical Reports – Migrates financial and legal interfaces which currently rely on IMF data provided by the 701 program to leverage data provided by the CADE 2 database.
	Paused	ADS	Authoritative Data Source Transcripts – Certain transcripts must leverage the CADE 2 Database prior to the end of Release 5 in order for CADE 2 to become the Authoritative Data Source.
	Paused	ADS	Feed to IDRS – Establishes two interfaces between CADE 2 and IDRS. The first creates the daily TIF extract file to send individual taxpayer accounts to IDRS. The second supports the MFREQ request/response interface to send individual taxpayer accounts to IDRS.

	Paused	ADS	Refunds – Establishes an interface from the CADE 2 database to IMF post-settlement runs which will continue to generate refund files and the Net Tax Refund Report (NTRR). Allows CADE 2 data to be used for refund generation.
	Paused	ADS	Unpaid Assessments (Authoritative Data Source) – The CADE 2 TS 2 UA Project is primarily responsible for modernizing the unpaid assessment system by sourcing the UA data files with CADE 2 data.
5.0	Underway**	IRE	Individual Tax Processing Engine – Establishes the foundation for a modernized tax processing engine by converting the core IMF functions of posting, settlement, and analysis (runs 12 and 15) into Java-based programs.
	TBD	IRE	701 Replacements – Enables the retirement of the IMF 701 extract application by recreating IMF 701 data extracts from the CADE 2 database.
6.0	Paused	FMW	P&I and Credit to Debit Allocations – Allows individual tax assessments to be stored at the assessment level and the allocation of debits and credits to those tax assessments on the CADE 2 Database. Enables P&I common code to correctly calculate and store P&I at the assessment level on CADE 2.
	Paused	FMW	Financial Status & Notice History – Establishes an interface from IDRS to CADE 2 to provide and store financial status and notice history information in the CADE 2 Database, enabling a complete audit history of individual taxpayer accounts. The update will be made as a direct load to the database. The data will be made available to downstream systems. (FMW 4)
	TBD	FMW	Enhanced Unpaid Assessments Reporting (FMW) – Modifies data extracts from CADE 2 to RRACS and FMIS to include additional information related to the Unpaid Assessment FMW. Requires changes to RRACS, CDDDB, UA, and other financial systems.
	TBD	FMW	Enhanced Transcripts Reporting (FMW) – Enables the capability for transcripts to contain additional financial status & notice history as well as audit information from the CADE 2 database.

Questions for the Record
Ways and Means Committee
Understanding the Tax Gap and Taxpayer Noncompliance
Thursday, May 9, 2019
(Rep. Darin LaHood)

Questions for The Honorable J. Russell George, James R. McTigue, and Benjamin Herndon:

1. The most recent IRS study, in May 2019 of the tax gap found the average annual tax gap for 2008-2010 is roughly \$458 billion. Does the IRS, TIGTA or GAO have any data to confirm that the 45B credit has been successful in helping restaurant employers to encourage accurate tip reporting among their employees? Any data to show it hasn't helped?

Answer: The IRS is not aware, as of May 2019, of any studies that address these questions about the 45B credit. (All information in each answer is accurate as of May 2019.)

2. The TIGTA report confirms that compliance has increased since implementation of tip agreements and that compliance is higher than would be achieved under regular examinations. How would voluntary use of TRAC agreements assist the IRS in compliance efforts?

Answer: The IRS utilizes voluntary tip agreements to improve tip reporting compliance while reducing the burden for employees, employers, and the IRS. IRS compliance efforts are assisted by the Tip Reporting Alternative Commitment (TRAC) agreement and other tip agreements when a participating employer adheres to the commitments in the agreement resulting in accurate tip reporting by employees.

3. A significant area of concern for salon owners is when their trained employees, who are subject to withholding, move to work as freelance stylists in non-employer salon establishments where they are required to report their business income themselves. Not only must they file estimated tax returns, but they must also file information reports regarding rental payments they make to landlords that are organized as unincorporated businesses.
 - a. We have heard from operators of chair rental establishments that they seldom, if ever, receive Forms 1099 from their chair renters. What does your data show regarding the level of compliance with information reporting requirements in the salon industry with respect to such rental payments?

Answer: The IRS is not aware of data that could provide a reliable answer to this question given the question's very narrow focus and complications stemming from different requirements for information reporting depending on the type of business entity that receives the rental payments.

- b. There has been a substantial shift in the salon industry from employer-based salons to non-employer establishments, such as chair rentals and salon suites. What steps could be taken to improve compliance when such individuals who are subject to withholding and information reporting move to situations where there is neither?

Answer: Compliance may improve through increasing education and targeted outreach to the cosmetology industry. Currently, taxpayers may access the Self-Employed Individuals Tax Center on www.irs.gov. This site provides information for self-employed individuals to help them understand how to operate as a self-employed individual or independent contractor as well as their filing obligations.

- 4. What are the benefits to the IRS of changing the responsibility for filing the Form 1099, related to rental income, from the self-employed individuals to the landlord businesses who are more accustomed to complying with existing IRS information reporting requirements?

Answer: The IRS does not have the statutory authority to change this requirement.

- a. How could the IRS utilize such information?

Answer: The IRS could potentially use such information in document matching programs to identify potential non-filers since the receipt of the payment would indicate that the payor was engaged in a trade or business. The information could be used to augment current return selection criteria and as additional information for examiners.

- b. To what extent could the IRS connect the rental payment expense deducted by such small business (as a cost of doing business) against the income generated by the individual in such business?

Answer: The information could first be used to identify that there was a trade or business that should be filing and reporting income.

- c. Does information reporting of business expenses improve compliance by individuals?

Answer: Information reporting should improve compliance.

Generally, a payment that is reported by a business on an information return is not only an expense for that business but is also income to another entity. The “visibility” analysis conducted as part of the tax gap estimates shows that information reporting and withholding are associated with more accurate reporting of income by the recipients of that income who file individual income tax returns. (See response to Question 4b below.)

It has also been suggested that information returns have the potential to be used to ensure that the entity filing the information return is not overstating its business expense. See GAO/GGD-93-133.

- d. If the IRS receives a Form 1099 indicating a rental payment has been made, can it be assumed that the IRS has the capacity to compare it to a corresponding individual income tax return?

Answer: The IRS already matches existing Forms 1099 to individual income tax returns. New forms or additional matching require resources to program and implement, including the capacity to match the referenced Form 1099 information to specific line items on the individual income tax returns.

- e. To what extent does the existence of an information report increase taxpayer compliance, notwithstanding the fact the IRS may never completely utilize the information in its enforcement activities?

Answer: Analysis and reporting suggest that information reporting improves compliance.

The “visibility chart” that is developed as part of the IRS’s individual income tax underreporting tax gap highlights the positive relationship between information reporting/withholding and the voluntary reporting of different types of income. Wages income that is subject to both information reporting and withholding provides the most accurate reporting. The accuracy of income reporting declines as the requirement for and scope of information reporting declines.

The chart, found on page 5 of the document at this [link](https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf) (<https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>), shows that income misreporting, as measured by the Net Misreporting Percentage, is worse when there is less information reporting and no withholding.

Questions for Benjamin Herndon:

1. TIGTA issued a report in September 2018 regarding tip-related tax noncompliance. The report relied extensively on data supplied by the IRS. For example, the IRS estimates that 10 percent (\$23 billion) of the estimated individual income tax underreporting Tax Gap (\$235 billion) is due to unreported tip income by employees.

a. In the salon industry, not everyone who receives tips is an employee. To what extent does the \$23 billion figure include free-lance workers?

Answer: A distinction needs to be made between unreported tip income and the tax gap associated with unreported tip income. The cited figure of \$23 billion refers to unreported tip income; the unreported tax on that unreported tip income is significantly less. Therefore, the tax gap associated with unreported tip income is also significantly less than 10 percent of the estimated individual income tax underreporting tax gap. For the TY 2006 individual income tax underreporting tax gap estimates, the IRS estimated that of an estimated \$44 billion in “true” tip income, approximately \$23 billion of tip income was not reported. That estimate includes tip income received both by employees and by self-employed workers who report income on a Schedule C. The TY 2006 tax gap estimation methodology does not provide separate estimates of unreported tip income for employees versus the self-employed; only the total amount of tips earned and unreported.

b. Between 2005 and 2015, the number of salon establishments without payroll employees grew by more than 400,000. To what extent are these self-employment operations factored into your tip numbers?

Answer: The individual income tax underreporting tax gap estimates do factor in underreported tips for both employees and self-employed workers. For the self-employed, “tips” are just part of the gross receipts from the business. The published tax gap estimates do not separately report underreported tip income and the associated underreported tax but they are factored into the tax gap estimates.

c. Footnote 15 in the TIGTA report notes that the IRS does not have an individual unreported tip estimate for the reported TY2008-2010.

i. Why is your most recent data from 13 years ago?

ii. Why wasn’t unreported tip data included in the most recent tax gap study?

Answer: The TY 2008-2010 individual income tax underreporting tax gap estimates do include estimates of the tax gap associated with underreported tip income. In the published tax gap documents, tip income is not reported separately. However, for employees, an estimated \$11.7 billion in tip income was underreported annually for the

TY 2008-2010 period. This corresponds to about \$1.5 billion per year in underreported individual income tax. For the self-employed, the methodology used for the TY 2008-2010 tax gap estimates (which differs from the methodology used for TY 2006 estimates) does not separately estimate underreported “tips” from all the other sources that make up gross receipts. Consequently, there are no separate tip income-related estimates for the self-employed and unreported tips received by the self-employed are included with other unreported gross receipts. These estimates for the TY 2008-2010 timeframe, which were released in April 2016, are based on examination (audit) data for those tax years. Individual income tax returns are due in the year following the tax year (for example, tax year 2010 returns are filed in 2011). The audit data used in the estimation are based on a sample of tax returns audited under the National Research Program (NRP) that are statistically representative of the population of individual income tax returns. The completion of these audits, which include simple as well as complex returns, can take a few years. The analysis is conducted once the data files from the audit data are perfected. TY 2010 was the latest tax year data available during calendar 2015 when the TY 2008-2010 estimates were being developed.

Questions for the Record Submitted to The Honorable David Kautter

**Senate Financial Services and General Government Appropriations Subcommittee
“Hearing to review the Fiscal Year 2019 funding request and budget justification for the
U.S. Department of the Treasury”
May 22, 2018**

Questions for Acting Commissioner Kautter from Vice Chairman Patrick Leahy

1. I have been very concerned about the budget cuts directed at the IRS over the last several years. The Trump administration’s budget proposal for FY 2019 would continue cuts to the IRS that will impact key taxpayer services at a time when many Americans are confused about their new obligations under the Republican tax cut legislation. The IRS also experienced an embarrassing technical failure on the last day taxpayers had to file their taxes, requiring an extension in the filing date. At the same time, IRS enforcement efforts have dropped and the sensitive information of American taxpayers is under constant attack.

Q. How will further budget cuts, including reductions in taxpayer services (particularly in rural areas), improve the IRS experience for taxpayers in Vermont?

The IRS provides service through a variety of channels, which are funded through two different accounts. The Taxpayer Services account funds taxpayer services provided through toll-free phone lines, walk-in assistance at Taxpayer Assistance Centers, and correspondence. The Operations Support account funds the systems that support taxpayer services, a growing range of online taxpayer services, and web-based self-assistance tools. The 2019 Budget includes funding for taxpayer services as well as the underlying systems and new tools and technology which enable taxpayers to conveniently and securely engage with us anytime and anyplace- similar to any other financial institution.

2. Rural areas like Vermont have unique challenges when it comes to providing taxpayer services, which is why closing Taxpayer Assistance Centers (TACs) is so problematic. Attempting to replace in-person visits with online services doesn’t help Vermonters who lack broadband service. Replacing these visits with phone calls only helps if the IRS sets a target response rate that aims to serve everyone who makes a call.

Q. What consideration has the IRS given to the impact of TAC closures in rural areas that lack access to broadband?

We recognize that our obligation to serve all taxpayers requires the IRS to provide multiple ways to get assistance. The IRS is committed to finding ways to ensure all taxpayers have convenient and efficient service options. We will always provide service options that are alternatives to the internet, including face-to-face

and telephone service options. . The IRS makes decisions about location and staffing of TACs after evaluating population covered, distance between the TACs, services most frequently requested in the area, cost, and availability of alternative services, including services through our trusted partners. Toll-free phone lines continue to be the number one choice for getting assistance with account and tax law questions. The IRS answered more than 21.4 million calls this fiscal year through July.

To continue providing face-to-face services outside of the traditional TAC model, the IRS has been exploring various options. For example, as of August 21, 2018, we have 38 partner cities that host the IRS Virtual Service Delivery technology. This technology enables taxpayers to receive assistance from TAC employees in another geographic area of the country via an IRS computer and high-resolution video. Thus, the IRS is able to maintain virtual face-to-face services without placing any technology demands on taxpayers. Additionally, the IRS partnered with the Social Security Administration (SSA) to pilot a program that co-locates IRS TAC employees within SSA office space. These collaborations provide additional service channels in geographic locations without a TAC.

Additionally, the IRS continues to look for innovative ways of providing taxpayer services for taxpayers without broadband. For example, the IRS redesigned IRS.gov, making it mobile friendly. This means the site will resize and adapt based on the screen size or the type of device used, including a smartphone or tablet. Taxpayers can now use IRS.gov on their mobile devices, without needing access to broadband. Another example is the IRS2Go App, which is the official IRS smartphone application compatible with Apple and Android mobile devices. Taxpayers don't need a computer or broadband to check their refund status, make a payment, find free tax preparation assistance, sign up for helpful tax tips, and more. IRS2Go is available in both English and Spanish. In addition, we offer 100 commonly used Instructions and Publications in eBook format. IRS eBooks for mobile devices are free and are provided in the ePub format.

3. According to the Identity Theft Resource Center, there were a record-high 1,579 data breaches in 2017, compromising nearly 158 million Social Security numbers. The massive Equifax data breach impacted as many as 147.9 million Americans and exposed personally identifiable information that scammers can use to file fraudulent tax returns. It is clear that the number of data breaches is growing rather than shrinking.

Q. What steps has the IRS taken to protect taxpayers in the wake of the Equifax data breach?

We have taken significant steps in recent years to strengthen our information technology systems to protect taxpayers against identity theft and refund fraud. As part of our Security Summit partnership with state tax administrators and the private sector tax community, we have added new protections for electronically engaging with the IRS, including greater authentication measures and fraud detection filters for verifying legitimate tax filers and detecting identity theft tax

returns. These additional fraud detection filters and cross-checks make it harder for fraudsters to obtain fraudulent tax refunds, protecting taxpayers and revenue loss. We specifically designed these safety measures to work in the environment of large-scale data breaches, such as Equifax, where criminals obtained basic information such as names and Social Security numbers.

As it relates to the Equifax data breach specifically, we took immediate action to understand and evaluate the impact of the breach. Immediately upon notification, we conducted a comprehensive internal review and performed an on-site inspection at the Equifax facility. The on-site inspection confirmed that no IRS data was compromised. Additionally, in our continued efforts to combat cyber fraud and protect taxpayer data, we have seen no indications of tax fraud from information exposed in the Equifax data breach. We will continue to actively and closely monitor the situation.

Q. Does the IRS budget request take into account the potential for future spikes in data breaches?

Yes. The 2019 Budget includes a \$181 million initiative that would strengthen cyber security, provide higher levels of security for taxpayer data (improved identity assurance and authorization) and help maintain the currency of the agency's hardware and software, our most significant operating risk. Adequate funding for information technology operations is one of IRS's most critical needs.

4. During the Obama administration, Republicans attacked the IRS for what they perceived as politicized behavior by its leadership. While I believe these attacks were overblown, there is no question that it is important to ensure that the IRS is independent from political concerns. You currently serve two roles in the Trump administration, including a policy role at the Treasury Department that may require you to take political considerations into account.

Q. What assurances can you give this Committee that you are serving as Acting IRS Commissioner in a manner that is independent from political considerations?

I can assure you that as Acting IRS Commissioner, I am deeply committed to being independent in working to accomplish the mission of my organization, which is to provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Q. Do you believe you can adequately shield IRS employees from political pressure given your dual role in the Administration?

Yes. The IRS career employees provide high quality service to all American taxpayers on a fair and impartial basis, in an environment free of fear of retribution, retaliation or political pressure.

Q. Since becoming Acting IRS Commissioner, have you ever personally briefed or met with President Trump? If so, how many times?

I have not personally briefed President Trump in my role as Acting IRS Commissioner.

Questions for Acting Commissioner Kautter from Senator Van Hollen:

1. During the hearing, you testified that you were unaware of any detailed estimate performed by the Treasury Department for the impact of the new tax law on the debt, despite the Treasury Secretary's frequent claims that the tax law would pay for itself with economic growth. You further testified that, to your knowledge, the only analysis regarding this issue that has been "publicly released" was a one-page document that simply assumed higher economic growth without any analysis showing that the tax law would actually produce such growth. You later stated, however, that detailed analysis showing that the tax law would pay for itself may exist, but that you are, "just not aware of it at the Treasury Department."

If any detailed analysis exists to show how the new tax law will pay for itself with economic growth, at the Treasury Department or elsewhere, please provide that analysis.

For additional analysis on this topic from the administration, we would refer you to the detailed report published by the Council of Economic Advisors in October 2017 (available here:

<https://www.whitehouse.gov/sites/whitehouse.gov/files/documents/Tax%20Reform%20and%20Wages.pdf>).

Questions for the Record
The 2017 Tax Filing Season: Internal Revenue Service Operations and the Taxpayer
Experience
04/06/2017

Chairman Hatch

Commissioner, another area of critical importance is the fight against identity theft refund fraud. The Tax ISAC that IRS has created (Information Sharing and Analysis Center) is a strategically essential defense for the integrity of the tax system, just as are the ISACs in the Aviation, Financial Services and Healthcare sectors. But to be successful and effective, an ISAC is dependent on secure and confidential information sharing by all parties.

What are the obstacles if any to IRS being able to be a full participant in its own ISAC? Are any obstacles insurmountable under current law, and, if so, what do we need to do to enable the Tax ISAC to be robust and optimally effective?

Likewise, what if any funding does IRS need to ensure that the ISAC is fully successful in the fight against tax refund cyberfraud?

We chartered the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (IDTTRF-ISAC) in December 2016 and began pilot operations at the beginning of this filing season on January 23, 2017. The IDTTRF-ISAC is a natural outgrowth of our Security Summit activities which began in 2015 to look holistically at the tax refund identity theft problem across a return's lifecycle. The purpose of the IDTTRF-ISAC is to share identity theft tax refund fraud data and related analysis with public and private entities in order to detect, prevent, and deter identity theft tax refund fraud. As of late April 2017, the IDTTRF-ISAC has 36 member organizations from state departments of revenue and the tax software and tax preparation industries.

The two primary capabilities we are piloting this year are: 1) sharing of tax ecosystem alerts; and 2) analyzing leads generated by the tax software and tax preparation industry as well as other member data. Tax ecosystem alerts are akin to a neighborhood listserv for the tax ecosystem. Members report any tax ecosystem threats they encounter so that others can protect themselves against the threat. Thus far, threats have included employer W-2 breaches, compromised return preparers, new schemes, and dark web chatter about system vulnerabilities. Allowing one member's detection to be another member's prevention is a powerful paradigm. Already, the IDTTRF-ISAC has received indicators that members are using alerts to identify suspicious returns in their own systems and stop the further processing of returns seeking fraudulent refunds.

With regard to the second capability, namely the analytical function, members submit data to the IDTTRF-ISAC for the purposes of finding anomalies indicative of potentially fraudulent activity. This capability, of course, is dependent on the volume and quality of the data the IDTTRF-ISAC receives. In preparation for Filing Season 2018, the IDTTRF-ISAC plans several data experiments this summer to help identify data with the greatest predictive capacity. We

anticipate the IDTTTF-ISAC will realize fuller capability in the next filing season with its increased number of members and a better understanding of what data is most relevant to identifying and reducing identity theft fraud.

Under the law, we are limited in the ability to share with the IDTTTF-ISAC and certain other external organizations fraudulent or potentially fraudulent data received on a tax return. Section 6103 protects largely all data on a return received by the IRS or gathered by it in connection with the processing of the return, whether the return was filed by the true taxpayer or a fraudulent taxpayer.

We will spend an estimated \$3.9M in FY 2017 operating the ISAC. In addition, the IRS plans to spend \$4.7M in FY 2016 expired balances for IDTTTF-ISAC activities in FY 2017, as outlined in the May 2017 letter to the House and Senate Appropriations committees.

Ranking Member Wyden

Question 1

Ever since Watergate, it has been routine for Presidential nominees and sitting Presidents to release their tax returns. Public disclosure is all the more important today, when serious questions about conflicts of interest and ties to foreign governments hang over President Trump and his administration.

IRS procedure requires that the IRS audit the individual income tax returns of the President annually, and provides for an expedited audit process. While I understand IRC section 6103 limits your ability to discuss information related to individual taxpayers, I respectfully request you provide answers to the following questions with respect to the underlying IRS policy that requires audit of the tax returns of any President.

- a) How can the IRS guarantee to the American people that the audit of the President's tax returns is independent of political pressure from the White House or other groups?**

The IRS follows the laws and policies in effect that ensure examination of a President's tax return is independent of political pressure. Experienced IRS employees, whom we select to conduct sensitive examinations of this type, are subject to federal Civil Service laws that protect them from being disciplined or terminated without appropriate cause. IRS employees are specifically trained to recognize and report inappropriate interference with an examination to the Office of the Treasury Inspector General for Tax Administration (TIGTA) for investigation.

In addition, the Internal Revenue Manual provides instruction for handling an examination of a President's individual tax return. Furthermore, the examination is subject to mandatory quality review by Examination Technical Services under IRM 4.2.1.11. This review evaluates the examination of the President's tax return against objective criteria and provides an internal system of checks and balances to ensure that the completed audits are technically and procedurally correct.

- b) The requirement to audit the President's tax returns is provided under the Internal Revenue Manual (IRM), which is neither statute nor regulation. Given that this mandate exists only under IRS procedure, is it possible for the IRS, Treasury Department, or White House to exempt the President's tax returns from this requirement?**

The individual income tax returns for the President and Vice President that are filed while they are in office are subject to mandatory examinations by the Internal Revenue Service as a matter of IRS policy and procedure, and described in the Internal Revenue Manual since at least 1977, now at IRM 4.2.1.11. We have no plans to modify this longstanding policy.

- IRC section 7217 prohibits the President and employees of the Executive Office of the President from interfering in the audit of any specific taxpayer. An exception to this prohibition applies to cases in which the Secretary of the Treasury intervenes in an audit as a consequence of the implementation of a change in tax policy. As such, can IRS definitively state that any revision to revoke or limit the scope of IRM 4.2.1.11 at the direction of the White House, Treasury Department, or IRS Commissioner is prohibited under IRC section 7217? Please explain your interpretation of this provision.**

We have no plans to modify the scope of IRM 4.2.1.11.

- c) IRM 4.2.1.11(1) specifically requires audit of the *individual* income tax returns of the President. How does the IRS interpret the term "individual?" Does this include any business tax returns or information returns? Does this include tax returns of partnerships, corporations, or trusts wholly owned by the President? Does this include the tax returns of related parties who are engaged in business with the President, such as the President's adult children? Please describe any limitations IRS faces due to the scope of the mandatory audit.**

Individual income tax returns are those filed on the Form 1040 series, which do not include business tax returns or information returns. However, under IRM 4.2.1.11, examiners may review a President's "related returns" in accordance with procedures that apply to all taxpayers. According to IRM 4.10.5.4, *Related Returns*, returns are related if adjustments made to one return require corresponding adjustments to the other return to ensure consistent treatment, or the returns are for entities over which the taxpayer has control and which can be manipulated to divert funds or camouflage financial transactions. Therefore, returns of businesses a President owns or returns of family members may be included in an examination of the President's individual income tax return if they are related. There are no specific limitations regarding the scope of a mandatory return examination.

- d) Are IRS agents qualified to identify ethical conflicts of interest that may arise as part of the audit of the President's tax returns? Would doing so be within the scope of their authority?**

This matter is not within the scope of a return examination.

- e) Are IRS agents qualified to identify ties to foreign governments which could undermine the integrity of the United States government? Would doing so be within the scope of their authority?**

This matter is not within the scope of a return examination.

Question 2

On January 30, 2017, President Trump issued Executive Order (EO) 13771, titled “Reducing Regulation and Controlling Regulatory Costs.” The EO requires that “for every one new regulation issued, at least two prior regulations be identified for elimination.”

- a) What challenges does the IRS face in determining the types of guidance that are covered by the EO? For example, are Revenue Rulings or Letter Rulings, which some taxpayers may rely on for certainty, covered by the EO?**

Under EO 13771, the Office of Management and Budget (OMB) issues guidance on the implementation of the EO, including what actions are subject to the EO’s requirements.

- b) Could IRS compliance with the EO impair the ability of taxpayers to properly calculate their federal tax obligations?**

The Treasury Department and the IRS are working with OMB to comply with the Executive Order. We do not anticipate that the EO will impair taxpayers’ ability to properly calculate their federal tax obligations.

- c) Do you expect that compliance with the EO will require significant IRS resources? If so, could you estimate the resources that will be needed – such as the number of hours IRS employees will spend?**

The Treasury Department and the IRS are working with the Office of Management and Budget (OMB) to determine how the Executive Order applies to Treasury and the IRS.

- d) Could the EO increase the likelihood of a loss of federal revenue directly, through lacking guidance, or indirectly, through the redirection of IRS employee resources?**

The Treasury Department and the IRS are working with OMB to comply with the Executive Order. We do not anticipate that the EO will increase the likelihood of a loss of federal revenue directly or indirectly.

- e) **Could the EO prevent or slow down the issuance of critical guidance needed to swiftly shut down abusive transactions, like certain inversion transactions or other abusive emerging tax strategies?**

The Treasury Department and the IRS are working with OMB to comply with the Executive Order. We do not anticipate that the EO will prevent or slow down guidance needed to address abusive transactions.

Senator Bennet

QUESTION #1

Congress slashed the IRS budget by 16 percent in real terms from 2010 to 2016 with corresponding reductions in its workforce. As you've noted, these cuts also came as the IRS took on increased responsibilities.

You've expressed concerns about this funding squeeze affecting voluntary tax compliance. This is a particular risk given that many of our constituents become frustrated as they are not able to get the help they need from the Service due to unanswered calls or long wait times.

You've noted that even a modest reduction in voluntary compliance could have an effect comparable with the entire amount of revenues collected through enforcement.

- **Have you seen any early trends in voluntary tax compliance so far this filing season?**

Through the week ending May 12, 2017, we processed 134,127,000 individual income tax returns compared to 134,438,000 from the prior year. However, it is too soon to identify any trends because taxpayers with automatic filing extensions still have until October to file a return. Also, taxpayers without a filing requirement, but who file tax returns for other reasons, may file a return after the April due date. We will continue to monitor return filings throughout the remainder of the year.

- **Given that the President's skinny budget proposes to cut the IRS budget further, what effect would those cuts potentially have on voluntary compliance?**

Effective service and enforcement programs are essential to maintaining and improving voluntary compliance. We will continue to develop our analytic capabilities to improve case selection and management to maximize collections, reduce taxpayer burden, and shorten the enforcement cycle.

QUESTION #2

I know that Congress has reduced the Service's budget and that your team is often just trying to deliver a basic level of service alongside desperately needed modernization with the funding you have.

- Setting aside the current politics and funding constraints, what would an ideal system of tax administration and tax enforcement in the United States look like to you and roughly how much do you think it might cost?**

Under an ideal system of tax administration and enforcement, taxpayers and the IRS would be able to interact in the same way that individuals interact with their banks and financial institutions. The IRS plans to provide taxpayers with an account where they, or their authorized representatives, can log in securely, get information about their tax account, and interact with the IRS as needed. The IRS realizes that not all taxpayers are capable of or comfortable with interacting with us online, and for this reason we will maintain the ability for taxpayers to discuss their tax situation with us in person at an IRS assistance center or by telephone through our toll-free taxpayer assistance line. Our goal is to make online systems available for the many taxpayers who want to interact with us this way, freeing up more resource-intensive in-person assistance for those taxpayers who are unable or uncomfortable communicating with us electronically.

The IRS also aims to make IRS interactions with taxpayers about anomalies or potential noncompliance more timely, which means identifying issues earlier, contacting taxpayers sooner, and resolving issues faster. This would be accomplished in part through a more robust anomaly detection capability that leverages available information, historical patterns, service and enforcement results, and established precedents. Once it is determined that taxpayer contact is warranted, taxpayers could be informed, either through their account or other communications and outreach channels, and would be afforded the opportunity to self-correct errors, provide additional information, or explain the anomaly. Self-correction and early opportunities to provide additional information and explain anomalies could help reduce contentious compliance issues in later years.

Here are some of the key building blocks of the improved tax administration and enforcement capabilities.

Virtual Taxpayer Assistance Center

In the virtual taxpayer assistance center, taxpayers could securely access and control account information. They would be alerted to account updates via this method if they have identified that this is their preferred communication channel. Taxpayers could see return and refund status, payment confirmations, letters mailed, or completed actions, all on one convenient account history page. The virtual taxpayer assistance center would include secure and easy-to-use self-service tools for taxpayers and their representatives, with clear steps to resolve most errors and issues, seek a tax refund, or make an online payment. The need for phone calls and correspondence would be greatly reduced.

Identity Authentication

The IRS must continue to protect taxpayers' private information and confirm that we are interacting online and on mobile devices with the right person when we implement the IRS Future State. While we have made significant strides, we need to continue our efforts to expand and evolve our capabilities to authenticate taxpayer identities and secure their data as part of building systems to implement the Future State. Strong systems for identity authentication help to ensure taxpayers have secure access whenever and wherever needed, including when the taxpayer communicates with IRS systems using the virtual taxpayer assistance center.

Up-Front Issue Identification

The ability for the IRS to find errors and issues in a tax return within a short time after the taxpayer files that return is central to detecting and resolving discrepancies early and efficiently. This is in contrast to today, when the taxpayer may wait months after filing a return to hear from us. Developing better up-front issue identification capabilities as part of the Future State would help us take immediate actions such as keeping a false refund out of the hands of an identity thief or finding an unclaimed tax credit on the taxpayer's return.

Better access to data sources would also help us detect issues more quickly after a return is filed. Recent legislation requiring employers to file Forms W-2 earlier enables IRS validation of income reporting in filed returns in a more timely manner. The 2018 Budget includes proposals for (1) correction authority for specific errors to help resolve problems if reliable data contradicts information on a tax return; and (2) correction authority when IRS return data shows taxpayer deductions or credits exceed statutory limitations.

End-to-End Taxpayer Experience

As part of the Future State, we plan to build the capabilities to ensure that taxpayers experience seamless interactions with us, no matter which of our employees or teams are working with them. An integrated case management capability would also increase IRS efficiencies by allowing us to move information to and among the right workgroups electronically, without delays caused by mailing of case files. For example, this capability would permit multiple expert employees to contribute to complex audits through online sharing of audit materials. It would also allow for a taxpayer's audit case to move from examination to appeals quickly and without the need to transfer voluminous paper files.

Expanded Data Analytics Capabilities

Integrating the latest developments in data analytics into IRS systems is an important aspect of the Future State. Incorporating the latest generation of data analytics into IRS systems will enable the IRS to improve tax administration and the taxpayer experience through a "test and learn" process by continuously collecting and evaluating data. Data analytics enables the IRS to use the data feedback loop to improve the efficiency and effectiveness of our interactions. Through analytics, we would get early warning of new tax issues and could help taxpayers to avoid them by both working directly with taxpayers and working with return preparers and tax software providers to establish remedies. Analytics will also make audits faster by reducing taxpayer burden.

- **Are there countries whose public revenue collection agencies deliver an exceptionally high quality of service to their citizens? Are there practices you would borrow from them?**

Australia, Belgium, New Zealand, Norway, and many other countries, offer online portals through which their citizens can interact with their tax administrators. These portals offer a variety of online services, including tax and other information, forms and calculators, electronic filing of tax returns, electronic payment options, and secure detailed taxpayer information. These online services are easy and attractive for taxpayers to use, making it easier for them to comply with the law and receive a high standard of service, while the tax administrators benefit from lower costs and greater voluntary compliance. The IRS, through its participation in the Organization for Economic Cooperation and Development's (OECD) Forum on Tax Administration, is able to learn about the practices in other tax administrations and is working to incorporate similar types of online opportunities as part of our Future State project.

Senator Cantwell

QUESTION 1

Last year, Congress decided in a bipartisan way to increase funding for the IRS in order to improve customer service, prevent identity theft and improve cyber security. I was heartened to hear Secretary Mnuchin say during his confirmation hearings that the IRS was “understaffed” and “under-resourced” and hoped we could move beyond the era of punitive budget cuts for the IRS and make the Service the most efficient and effective it can be.

I was disappointed along with many of my colleagues by the \$239 million budget cut the President proposed for the IRS, nearly erasing the bipartisan efforts we made last year.

- 1. Can you describe how the IRS has spent the additional money Congress appropriated last year for increased cybersecurity? How has the IRS improved its cyber capability, and how would a cut in funding impact your ability to fight identity theft and protect taxpayers?**

In FY 2016, we spent \$72M , and plan to spend an additional \$78M in FY 2017, of the Sec. 113 Administrative Provision on IRS cybersecurity, including labor (The following projects span multiple years and are designed to strengthen IT security controls:

- **Cybersecurity Skills and Workforce – The IRS successfully recruited high quality candidates to fill IT security roles that were vacant through attrition or newly created to support mandates or initiatives that improve protections for critical infrastructure and taxpayer data. The IRS also invested in enhancing workforce skills through training, accreditations, and certifications.**
- **User and Network Security – The IRS will update its Personal Identity Verification (PIV) enablement solution that controls both physical access to IRS facilities and**

virtual access to IRS systems. This update requires the IRS to replace its installed network equipment that lacks the necessary software to improve security.

- Enterprise Operations Infrastructure Security – The IRS continues to expand its Integrated Enterprise Portal (IEP) environment security protections and tools that detect and remediate attempted external attacks on IRS.gov via automated scripts, bots, and suspicious and malicious Internet Protocol addresses.
- Cyber Strategy and Improvement Plan (CSIP) – The IRS continues to implement the CSIP issued by OMB to identify and address critical Cybersecurity gaps and emerging priorities. The IRS has launched and continues to strengthen its Security Summit initiative. This initiative allows us to leverage external partnerships with the states and the tax industry to identify safeguards to protect federal and state tax accounts from identity thieves.
- Cyber Secure Data Technology – The IRS is enhancing its infrastructure and tools with modern capabilities to identify, isolate, and respond to current and emerging data security issues. This effort addresses critical needs in the IRS Computer Security Incident Response Center (CSIRC) security zone infrastructure, including bandwidth capacity expansions, required to adequately evaluate content and web traffic.
- Cyber Analytics and 24x7 Monitoring – The IRS continues to expand its advanced analytics and 24x7 monitoring capabilities. This will complement the Continuous Diagnostics and Mitigation (CDM) implementation led by the Department of Homeland Security to automate security controls, enhance deficiency management, and standardize risk reporting across federal agencies.
- IT Security Audits, Vulnerability Assessments and Remediation – The IRS used these funds to get contractor services, hardware, and tool enhancements to provide vulnerability assessments via enhanced attack simulations and exercises. These capabilities are essential to identifying weaknesses that we must incorporate into remediation plans across the IT infrastructure ecosystem.

A reduction in cybersecurity funds would severely limit our ability to deliver the multi-year implementation strategy described above to defend against the persistent and organized threat to the security of taxpayer information, their identities, and the tax refunds the IRS processes each filing season. In its FY 2016 report, *Security for Taxpayer Data and IRS Employees* the Treasury Inspector General for Tax Administration recognized information security as the number one management and performance challenge facing the IRS for the sixth consecutive year.

QUESTION 2

President Trump signed an Executive Order on January 30 that would require the elimination of two regulations for every one new regulation issued.

The Executive Order also instructs Agency Heads that the total incremental cost of all new regulations, including repealed regulations to be finalized in 2017 shall be no greater than zero, unless otherwise required by law or consistent with advice provided in writing by the Director of OMB.

- 1. To what extent is the IRS impacted by the Trump “two for one” Executive Order? What types of notices has the IRS identified that would be impacted by the Executive Order?**

The Treasury Department and the IRS are working with OMB to determine the scope and effect of the Executive Order.

- 2. Has the IRS compiled its list of regulations to be eliminated? What types of tax regulations will be proposed for elimination? Does it include all guidance, notices and revenue rulings?**

The Treasury Department and the IRS are working with OMB to comply with the Executive Order. In relation to EO 13789, on July 7, 2017, Treasury and the IRS issued Notice 2017-38, identifying eight regulations as meeting the criteria of EO 13789.

- 3. To what extent will the “two for one” edict hinder the IRS’s ability to provide appropriate guidance to taxpayers?**

The Treasury Department and the IRS are working with OMB to comply with the Executive Order. We do not anticipate that the Executive Order will hinder our ability to provide appropriate guidance to taxpayers. We have been able to publish regulations and issue so-called “sub-regulatory” guidance in the form of revenue procedures and letter rulings, which are helpful to taxpayers interpreting the Internal Revenue Code.

- 4. Has the Director of OMB provided the IRS with guidance on the implementation of the EO? For example, what are the standards for determining the costs of existing regulations that are considered for elimination? Or, has OMB told the IRS what its total amount of incremental costs is for issuing new regulations will be for 2017?**

The Treasury Department and the IRS are working with OMB to comply with the Executive Order.

QUESTION 3

I understand that last year, the IRS had informed software providers that tax returns for the 2016 filing season that did not indicate whether or not the taxpayer was complying with the Affordable Care Act’s mandate would be automatically rejected by the Service.

After the President’s executive order on Obamacare was issued on January 20th, the IRS reversed this policy, and will continue the current practice of accepting these “silent” returns.

- 1. Does the IRS anticipate this change will lead to fewer people obtaining health insurance coverage or raise the price of health insurance coverage for other people because fewer people will obtain coverage? Was any analysis of the impact of this change on coverage or prices undertaken before this decision was made?**

Consistent with the President's executive order directing federal agencies to exercise authority and discretion to reduce burdens under the Affordable Care Act (ACA), we decided to continue to allow electronic and paper returns to be accepted for processing for the 2017 tax filing season in instances where a taxpayer does not indicate whether he or she has health insurance coverage as we had in previous years. However, the ACA is still in force until changed by law, and taxpayers remain required to follow the law and pay what they may owe. The IRS administers the ACA consistent with the statute and the executive order. The IRS does not have the capability of measuring impact on coverage or prices.

- 2. Is the IRS considering any other regulatory changes regarding enforcement of the individual mandate? Can the Administration direct the IRS not to collect this penalty?**

We are not considering any regulatory changes regarding enforcement of the individual mandate at this time.

- 3. I understand that during the past open enrollment period, the IRS coordinated with the Department of Health and Human Services to inform taxpayers who had not previously obtained insurance what their potential individual responsibility payment could be and encourage them to instead obtain coverage. Do you plan to continue this practice in the upcoming open-enrollment period?**

We understand that the Department of Health and Human Services is developing plans for the next open-enrollment period, and defer to it for information about those plans. The IRS has not made a decision as to whether we will issue notices to uninsured taxpayers.

QUESTION 4

On January 19, 2017, it was reported that the IRS would propose regulations to implement the centralized partnership audit regime that was passed by Congress as a part of the Balanced Budget Act of 2015, and later amended by the PATH Act. However, those proposed rules were never officially published in the Federal Register after President Trump's inauguration.

- 1. Why were the proposed rules not published? Have they been delayed or cancelled? What is the current timetable for the issuing of these regulations?**

Proposed regulations to implement the new centralized partnership audit regime were sent to the Federal Register, but were withdrawn prior to publication in the Federal Register in compliance with the White House Chief of Staff's memorandum issued on January 20, 2017. Proposed

regulations to implement the centralized partnership audit regime were resubmitted to the Federal Register and published on June 14, 2017.

Senator Cornyn

QUESTION #1

Mr. Commissioner, last month I sent you and Attorney General Sessions a letter about the enforcement of the so-called “Johnson Amendment” and its interaction with both the First Amendment and the Religious Freedom Restoration Act. As you know, the Johnson Amendment prohibits churches and other houses of worship that are deemed as a 501c3 organization, or a non-profit, from engaging in certain campaign activities. My constituents have concerns about the agency’s approach on this issue and I share their concerns. The Johnson Amendment has been a burden for some churches for a number of years – casting a shadow over what can be said in a sermon and other communications that some religious institutions may wish to make to their members about politics or candidates.

In 1993, President Clinton signed into law The Religious Freedom Restoration Act. This statute says that the government shall not substantially burden a person’s exercise of religion – even if the burden results from a rule of general applicability. The statute allows a substantial burden of a person’s exercise of religion only if the government demonstrates that its action is in furtherance of a compelling government interest and is the least restrictive means of furthering that compelling governmental interest. This requirement applies broadly to all federal laws – including the Johnson Amendment.

In my letter I suggested that the IRS and the Department of Justice conduct a thorough review of the interaction between the Johnson Amendment and both the First Amendment and the Religious Restoration Act of 1993. Furthermore, I asked that the IRS and DOJ consider suspending enforcement, including audits and examinations under the Johnson Amendment until a review has been satisfactorily completed.

Some argue that the 1993 Religious Restoration Act allows houses of worship to speak to their members about matters of religious conviction, including political issues or candidates, and the government cannot burden such speech by denying charitable tax status or other penalties. A law review article by Notre Dame Law professor Lloyd Mayer entitled, “Politics at the Pulpit: Tax Benefits, Substantial Burdens, and Institutional Free Exercise” discusses the 1993 Act in context of the Johnson Amendment. The Professor concludes that “...the government will have a difficult time demonstrating that they are compelling and that the prohibition as applied to sermons is the least restrictive means for furthering them.”

- 1. Could you tell me if your agency is conducting a review of the Johnson Amendment and how it interacts with the First Amendment and the Religious Restoration Act of 1993? If so, when do you expect the review will be completed by?**

We appreciate receiving your letter dated March 15, 2017 about the “Johnson Amendment” and its interaction with the First Amendment and the Religious Freedom Restoration Act of 1993 (P.L. 103-141). As I explained in my response dated April 11, 2017, we do not take a position on matters of tax policy, and we defer to the Congress as to whether the Johnson Amendment or other tax laws should be changed. We strictly adhere to the protections that the First Amendment and federal statutes, including the Internal Revenue Code and the Religious Freedom Restoration Act of 1993, provide to churches, religious organizations, and other taxpayers.

2. What are your thoughts about suspending IRS enforcement activities under the Johnson Amendment until there is a better understanding of the burdens that churches and other houses of worship face?

We have an obligation to administer and enforce the tax law as enacted, with due regard to the Constitution as well as other federal statutes and guidance. We defer to Congress and the Department of the Treasury to set tax policy.

3. Could you explain to the Committee the audit process that churches and other houses of worship go through?

The Exempt Organizations office of our Tax-Exempt/Government Entities Division considers a wide range of compliance issues, including political campaign intervention, before initiating an audit. To initiate a church audit, section 7611 of the Internal Revenue Code imposes a high standard that generally requires an approving IRS official to reasonably believe that the church has not met its tax obligations, such as withholding employment taxes and filing employment tax returns, or has engaged in activities resulting in private inurement or impermissible political campaign activities, such that the organization may not qualify for tax exemption based on a written statement of the facts and circumstances. If the reasonable belief requirement is met, the IRS begins an inquiry by providing a church with written notice explaining its concerns. If the church fails to respond within the required time, or if its response is insufficient to alleviate IRS concerns, the IRS may, generally within 90 days, issue a second notice, informing the church of the need to examine its books and records. After issuing a second notice, but before beginning an examination of its books and records, the church may request a conference with an IRS official to discuss IRS concerns. If at any time during the inquiry process the church supplies information sufficient to alleviate the concerns of the IRS, the matter will be closed without examination of the church’s books and records. Generally, examination of a church’s books and records must be completed within two years from the date of the second notice from the IRS. For more information about the audit process for churches, please see IRS Publication 1828, *Tax Guide for Churches & Religious Organizations*.

QUESTION #2

Mr. Commissioner, Congress passed the 1998 IRS Restructuring Act in part to curb IRS abuses. This legislation, among other things, requires the IRS to notify the taxpayer before contacting third parties regarding examination or collection activities with respect to the taxpayer. As benign as a third-party contact by the IRS would seem, it carries with it an

undeniable stigma. A taxpayer whose employer, friend, or neighbor, learns of an IRS audit or unpaid taxes unquestionably has a changed perception of that individual. Some cases might not impact that relationship or business, but more often than not a taxpayer will suffer irreparable harm.

I have heard from my constituents that the IRS is not meeting its commitment to protect taxpayers' rights regarding third party contacts. I have been told that in practice taxpayers are not being given a substantive opportunity to first provide the information to the IRS and that in many instances the IRS are circumventing these protections. In addition, the National Taxpayer Advocate has found that the IRS' third party contact procedures do not follow the law and may unnecessarily damage taxpayers' businesses and reputations. The Advocate listed this as one of the most serious problems facing the IRS.

The Advocate found that under current procedures, the IRS issues vague or non-specific Third-Party Contact (TPC) notices and potentially incomplete TPC reports that do not allow taxpayers to be informed about what information the IRS has decided it needs from third parties, whether it has actually contacted third parties, and how to obtain a list of the third party contacts.

I find this disturbing and I trust raises concerns for you as well. It is important that IRS agents are educated on the proper protection of taxpayer rights.

1. What is the IRS doing to ensure that the protections regarding third-party contacts are fully respected?

The IRS makes every effort to ensure our examination and collection processes, including third-party contacts (TPCs), are conducted fairly and impartially, balancing taxpayer expectations of privacy with the needs of effective tax administration. We are extremely sensitive to taxpayer concerns about reputational harm with respect to their tax matters. As a result, our procedures promote and prioritize open communication with taxpayers to gain their cooperation, encouraging them to voluntarily provide the requested information. When a TPC is necessary, we adhere to the provisions of Internal Revenue Code section 7602(c) and 26 Code of Federal Regulations (CFR) 301.7602-2, requiring us to provide advance notification to the taxpayer, make a record of each third party contacted, and provide a list to the taxpayer of third parties contacted upon request.

The IRS issues several publications to taxpayers, including Publication 1, *Your Rights as a Taxpayer* (Examination and Collection), and Letter 3164, *Third Party Notice* (Collection). Letter 3164 provides advance notice that a TPC might become necessary if the taxpayer does not have the ability to produce books and records as required by law, or if such a contact is required to verify information or document witness testimony.

In an examination, the examiner requests information from the taxpayer using Form 4564, *Information Document Request (IDR)*. Similarly, in the collection process, Form 9297, *Summary of Taxpayer Contact*, is used to request information needed to address collection tax issues. Information taxpayers voluntarily provide usually reduces the need to request information through other means, such as a third-party contact or a summons.

The IRS has additional procedures in place to ensure the protections regarding TPCs are fully respected, including managerial review of TPC cases and internal training.

2. Will you commit to my constituents that the IRS will consult with the Taxpayer Advocate and the Treasury Inspector General for Tax Administration and conduct a review of IRS' practice and guidance, including the Internal Revenue Manual, in this area?

The IRS is committed to the regular review of IRS policy and procedures. Internal Revenue Manual (IRM) 1.11.2, *Internal Management Documents System*, requires program owners to review the IRM at least annually for procedural, operational and editorial changes. Moreover, the IRS is continually looking for ways to improve its processes. As a result of a review of our current TPC practices and guidance, the IRS is updating IRM 25.27.1, *Third Party Contacts - Third Party Contact Program*, and revising TPC notices to instruct employees to inform taxpayers on how to request TPC reports. In addition, we are coordinating with the National Taxpayer Advocate on proposed procedural and policy changes on this issue.

3. What is the IRS doing in response to the Taxpayer Advocate's recommendations?

We are taking the following actions to address concerns in the FY 2015 NTA's *Most Serious Problems Annual Report to Congress*:

- Revising Publication 1, *Your Rights as a Taxpayer*, to include instructions on how to secure TPC listings;
- Updating Collection Letter 3164, *Third Party Notice*, to inform taxpayers of their right to receive post-TPC reports and instructions on how to request TPC reports;
- Updating Internal Revenue Manual (IRM) 25.27 and IRM 4.11.57, to include guidance to IRS employees on a taxpayer's right to receive information regarding TPC reports;
- Including TPC training as part of the Revenue Officers Continuing Professional Education (CPE) training;
- Including TPC training as part of the current Examiner CPE training; and
- Revising Field Examination's Third-Party Contact Procedures Job Aid to better clarify TPC procedures for examiners.

Senator Grassley

Question 1:

Recently, the Treasury Inspector General for Tax Administration (TIGTA) issued a report on the IRS' enforcement of structuring laws through civil asset forfeiture. TIGTA's review

of the program, spanning 2012 through 2014, showed the IRS enforced structuring laws “primarily against legal source funds.” This resulted in hundreds of individuals, many of which were small business owners, having their bank accounts seized with no evidence of any underlying criminal activity. This included an owner-operator of a small Mexican restaurant in Arnolds Park, Iowa. After public outrage at cases such as this, the IRS announced a policy change that it would only pursue cases in which there was underlying criminal activity, except in exceptional circumstances.

- **What procedures and protections you have put in place to ensure this new policy is being adhered to?**

Since implementing our new policy in October 2014 (described in IRM 9.7.1.3.1(6)), IRS-CI adopted a number of measures to ensure it is being followed, including the development of standard operating procedures, additional and annual training, and enhanced internal oversight. For example, in June 2016, we implemented standard operating procedures for the Bank Secrecy Act (BSA) violations. The procedures require that the seizure affidavit document meets the probable cause element for evidence of illegal source funds. Moreover, all seizure affidavits must be sworn by an IRS special agent and document the specified unlawful activity underlying the seizure. The special agent in charge must verify that seizures are not conducted independent of an ongoing criminal case. Seizures must generally be tied to an approved subject criminal investigation.

Our Financial Crimes section has quarterly BSA conference calls for field office special agents, task force officers, and their supervisors. In June and August 2016, supervisors, coordinators, and task force officers attended training at the National Criminal Investigation Training Academy, which we expect to repeat annually, including at a meeting scheduled in June and August this year. The BSA enforcement program requires case reviews of open structuring investigations, including a periodic review by the directors of field operations to verify compliance with IRS-CI policies for BSA enforcement. In addition, the Headquarters Review and Program Evaluation staff must review field office BSA enforcement programs.

- **The new policy still allows the IRS to pursue legal source structuring cases in “exceptional circumstances.” Could you help me understand what the IRS would consider an “exceptional circumstance”?**

While we have not specifically defined the term “exceptional circumstance,” we have advised our field offices that we will limit IRS-CI Headquarters approval to the rarest of situations.¹ One such example would be activity that connects the structuring activity to terrorism financing. To date, we have not used the exceptional circumstance exception for seizures.

- **I understand the IRS has notified individuals whose assets were seized after fiscal year 2009 that they may submit a petition seeking return of their funds. Could you**

¹ Memorandum for Special Agents in Charge Criminal Investigation, October 17, 2014, available at ij.org/wp-content/uploads/2015/07/IJ068495.pdf.

provide me with information on how many individuals the IRS has returned funds to, as well as how many have availed themselves of this process?

For individuals or business entities that received a notice under the petition for remission or mitigation process, our records reflect that 454 individuals and business entities filed petitions. The table below provides information about the disposition of the petitions as of May 3, 2017.

**SUMMARY OF THE IRS PETITION FOR REMISSION PROGRAM
ON SPECIFIC TITLE 31 STRUCTURING CASES**

	Judicial	Administrative	Total
Notices Issued	895	966	1,861
Petitions Received	246	208	454
Petitions Granted or Recommendation to Grant made to DOJ	188	174	362 (80%)
Petitions Denied or Recommendation to Deny made to DOJ	58	33	91 (20%)
Petitions Withdrawn	0	1	1
Petitions Paid (Quantity)	7	163	170
Petitions Paid (Dollar Value)	\$442,695.23	\$9,281,238.26	\$9,723,933.49
Total Approved Payments	\$709,239.23	\$10,034,324.33	10,743,356.56
Petition Payments Pending DOJ Approval	15,790,605.93		

Question 2:

During the IRS targeting investigation it became evident that the IRS had some gaps in its policies and procedures to safeguard electronic records, particularly emails. Since 2012, all agencies have been under an Office of Management and Budget (OMB) directive to “manage both permanent and temporary email records in an accessible format” by December 31, 2016. In compliance with this directive, the National Archives recommended all government departments and agencies adopt the “Capstone” approach for electronic management of email records. Has the IRS met its requirements under the OMB directive and fully implemented the “Capstone” approach for managing email records? If not, please explain why and when you expect the IRS to be in compliance.

The IRS takes its obligation to preserve federal records very seriously. Our efforts ensure records management practices adhere to the National Archives and Records Administration (NARA) and the Office of Management and Budget (OMB) M-12-18, Managing Government Records Directive, requirement.

In response to the OMB directive, we implemented an interim solution to archive email of IRS executives consistent with NARA guidance in October 2014. In 2015, we identified a cloud-based approach to meet the OMB/NARA Capstone requirements and made significant progress to meet the December 31, 2016 deadline. However, a bid protest filed with the Government Accountability Office (GAO) in March 2016, and upheld in June 2016, required us to re-compete

the solution to an on-premises based system. The revised approach required new procurement actions and the purchase and installation of hardware and software. Given the timing of the protest, we could not meet the December 2016 deadline. We are on course to implement the enterprise-wide NARA compliant solution for all agency email by the end of fiscal year 2017.

Question 3:

Thank you for your call the other day to update me on the IRS' progress in implementing the Private Debt Collection program. I appreciate your assurances that the IRS is working to make the program a success. One of the challenges facing previous iterations of the program was the limited volume of cases the IRS chose to place with private collection agencies. The success of the program depends on it achieving economies of scale so that efficiencies are realized. I understand the need for a testing period to ensure there aren't any process problems. However, once this is completed, can you assure me that the IRS is planning to move with deliberate speed to include all eligible accounts in the program so that the billions in revenue the Joint Committee on Taxation estimates the program can collect is realized?

The IRS delivered the first Private Debt Collection accounts to the Private Collection Agencies (PCAs) on April 10, 2017. As noted, the initial volumes were small to ensure there were no process issues. Over the next six months, we will increase the volumes with the goal of delivering nearly 140,000 accounts to the PCAs by the end of FY 2017. During this time, the IRS will continually evaluate the inventory delivered to ensure we give the PCAs the right mix and type of inventory. Based on this continuing evaluation, the IRS plans to deliver increased volumes of work through FY 2018, including more complex taxpayer accounts. This approach is designed to ensure that the maximum amount is collected under this program.

Question 4:

The Government Accountability Office (GAO) has issued two of three reports regarding the oversight and administration of the Low Income Housing Tax Credit program at my request to find out if it's being administered as intended. In the July 2015 report, GAO found that the IRS, the federal agency responsible monitoring and enforcing the program, provides only "minimal" oversight.

Specifically, GAO found that LIHTC is a "peripheral program in IRS in terms of resources and mission." Additionally, the IRS has only performed 7 audits of HFAs (of 56 total HFAs) between 1986 and 2015. GAO further stated, "As a result of minimal monitoring, IRS does not know the extent of compliance monitoring by HFAs, which limits its ability to determine if the HFAs appropriately awarded credits to projects." As such, state entities "increasingly" have missed the deadline to submit their annual report to the IRS and "often submit incomplete or inaccurate forms."

In the May 2016 report, the GAO concluded that the IRS doesn't give state and local agencies clear guidance on how to report program noncompliance and doesn't organize or track information from noncompliance reports. For example, the IRS has inputted less than two percent of the information from the LIHTC compliance Form 8823. Thus, there is no way to estimate taxpayer compliance or determine if any tax credits have ever been recaptured. Moreover, the IRS doesn't participate in the "interagency efforts to modernize,

standardize, and improve compliance monitoring of [LIHTC] properties.” GAO has provided a number of recommendations that would improve IRS oversight of the LIHTC program. Has the IRS implemented all of the recommendations? If not, why not.

To date, we have implemented three of the four GAO recommendations regarding Low Income Housing Tax Credits (LIHTCs). We participated in the Housing Finance Agency Portal 2017 Interagency Physical Inspection Alignment Initiative working group and the U.S. Department of Housing and Urban Development (HUD) Real Estate Assessment Center (REAC) team meetings to improve our understanding of the prevalence of noncompliance with LIHTC requirements and to leverage existing resources. We also have participated in bi-weekly REAC meetings throughout each calendar year since 2013 to ensure IRS inclusion in the REAC’s physical inspection alignment initiative.

We participated in the Physical Inspection Alignment Meetings at the National Council of State Housing Agencies Conferences (three per year) to assess the utility of the HUD-REAC database to improve our processes for identifying the most significant noncompliance issues.

Finally, we procured a new server that allows data on credit allocation and certifications to be input, thereby enabling us to better assess basic compliance requirements by using the credit allocation information in our database. This allows the IRS to implement a wide range of improvements to procedures and controls, including improved data entry control and report generating functionality; improved data reliability; and continued enhancements, such as the capability to produce additional reports that will allow management to review accuracy and anomalies more easily.

We continue to work on the remaining recommendation to receive more consistent information on LIHTC noncompliance, including a review of the Form 8823 Audit Technique Guide to determine whether allocating agencies need additional guidance and clarification to understand when to report noncompliance, building disposition or other information on Form 8823.

- **The IRS said an existing database would be converted to improve LIHTC monitoring and evaluation of data agencies submit on Form 8823. Has this been done? If yes, what have been the results of the increased monitoring? If not, when will the conversion be complete?**

The existing database has been moved to the new server. We continue to improve the database to allow full capacity to input data and offer a variety of reports that will estimate taxpayer compliance and allow the IRS to determine if any tax credits should be recaptured. These improvements are scheduled to be completed by September 2018.

- **LIHTC is significantly larger than the New Market Tax Credit program in terms of foregone revenue, yet the number of full- time equivalent (FTEs) personnel administering the LIHTC program is about 1/3 that of the New Market Tax Credit program (5.6 to 15). Please explain the disparity in the number of personnel administering these programs. What, if any, steps have been taken to increase the number of FTEs working on LIHTC. If none, please explain why.**

A direct comparison of IRS staffing of Low-Income Housing Tax Credits (LIHTCs) and New Markets Tax Credits (NMTCs) is difficult since these two credits differ in terms of their complexity and involve other organizations to assist in their administration. For example, the Internal Revenue Code provides both LIHTCs over a ten-year period and other tax benefits to investors in low income housing. The program is jointly administered by the IRS and state-authorized agencies that determine which proposed housing projects will be eligible to earn credits and how many credits are the maximum that can be earned by the project. These agencies also monitor properties for compliance with LIHTC requirements and report noncompliance to the IRS.

NMTCs, in comparison, are more complex. NMTCs, which are available over a seven-year period for investments in a qualified Community Development Entity (CDE), often involve multi-tiered, flow-through entity financing structures and large corporate taxpayers that have dozens of NMTC arrangements in place in a tax year. Examination of NMTCs requires IRS examiners with advanced tax knowledge of flow-through entities, particularly partnerships. Although the Community Development Financial Institutions Fund, another office within the Department of the Treasury, jointly administers NMTCs with the IRS, it does not assist the IRS with ensuring tax compliance during the seven-year period like the state agencies who jointly administer LIHTCs. These differences inform the staffing levels for administering each of these credits.

Question 5:

The Taxpayer Advocate's most recent report to Congress called into question the adequacy of the IRS' streamlined application for 501(c)(3) status, which it adopted in 2014. According to a 2015 study by the Taxpayer Advocate of organizations approved by the streamlined approach, 37% did not meet the organizational test for 501(c)(3) status. If accurate, this raises serious concerns about the ability of donors to rely on IRS determinations when making tax deductible donations. What, if any efforts, is the IRS undertaking to improve the streamlined application process to more accurately weed out non-compliant applicants in the pre-determination process?

Since implementation in 2014, Form 1023-EZ has dramatically reduced taxpayer burden and IRS back-log. To help identify potential compliance issues, the IRS conducts both pre- and post-determination review of Form 1023-EZ submissions. The IRS also continues to consider improvements to Form 1023-EZ based on its own experience and comments received from the public and other stakeholders. For example, in response to one of the recommendations the National Taxpayer Advocate made, the IRS will add to Form 1023-EZ a narrative question on the applicant's exempt mission or activities. The IRS also is considering additional questions that would assist applicants in confirming eligibility to use the form.

Question 6:

On June 9, 2016, I wrote a letter to you about my investigation into Mosaic Life-Care, a 501(c)(3) non-profit charitable hospital. I started the investigation because news reports at the time indicated that Mosaic had placed thousands of low-income persons in collection and sued many of them, rather than providing charity care as they are required to do as a

charitable hospital. Due to my investigation, Mosaic instituted a debt forgiveness program that resulted in thousands of low-income patients receiving, in total, \$16.9 million dollars in debt forgiveness. As you are aware, I authored nonprofit hospital reforms that were ultimately enacted in 2009. Among these reforms were requirements that nonprofit hospitals establish and make public a financial assistance policy (FAP) and imposing restrictions on certain billing and collection procedures.

In your June 27, 2016 reply, you noted that the IRS reviews 1,000 charitable hospitals annually to determine if any of them are out of compliance with the financial assistance policy requirements. Further, you noted that hospitals identified as potentially non-compliant are assigned to examination. As of June 2016, the IRS had identified 163 hospitals for examination but at the time of your letter the examinations had not yet been completed.

- Of the 163 hospitals under examination, how many cases have been closed by the IRS? For those examinations that have concluded, please detail the result of each examination and the corrective action employed by the IRS.**

In our June 27, 2016 response, we indicated that 163 hospital organizations had been referred for field examinations for potential violations of various provisions under section 501(r) of the Internal Revenue Code. Out of the 163 hospitals that had been referred, we have closed 55 cases as of March 31, 2017, with the following results for 45 of those cases: (1) 15 cases closed with no changes or adjustments; (2) 4 cases have been assigned to an examiner; and (3) 26 cases closed with a written advisory sent to the taxpayer and no follow-up actions required. To avoid disclosure of specific taxpayer information, we cannot disclose the results for the remaining 10 cases. These results may include an agreement to additional tax and penalties, a change to a related return, or a protest and review by our Office of Appeals.

- Separate from the 163 hospitals previously identified, has the IRS identified additional charitable hospitals for examination? If so, how many?**

As of April 28, 2017, we identified 436 additional charitable hospitals that have been referred for examination for potential violations of various provisions under section 501(r).

Question 7:

I want to bring to your attention reports of poor customer service at a Taxpayer Assistance Center (TAC) in Iowa. I understand as a matter of general policy TAC's no longer operate as walk-in centers, but require taxpayers to schedule appointments. While this general policy has caused confusion for taxpayers and made it more difficult for taxpayers to get assistance at TACs, it is not my primary concern. My concern is TAC's may be abusing this policy to turn away taxpayers in need of assistance. Many have complained of being turned away even though the office was completely empty, other than the 2 IRS employees that worked there. One taxpayer, who in fact had an appointment, was initially told she did not and was only served by the TAC employee after the employee looked through the computer system for 5 to 10 minutes to confirm the appointment.

- **Is it the IRS's policy to turn away taxpayers that don't have an appointment, even where TAC employees have no other appointments with taxpayers scheduled?**

We are serving all taxpayers that come into a TAC without an appointment if we have the capacity to assist them in between scheduled appointments. We also serve individuals by exception in cases of hardships. For example, for the fiscal year through April 22, 2017, TAC employees served more than 253,000 taxpayers without an appointment. Taxpayers that want to make a payment by check or money order, drop off a current year tax return, and get forms do not need an appointment. However, a taxpayer who wants to visit a TAC to resolve a tax issue should schedule an appointment. With the appointment process, our waiting rooms may not be occupied and it may appear that we are not assisting taxpayers. While our TAC employees are also responsible for administrative items, they spend the majority of their time serving taxpayers during their scheduled appointment or a walk-in customer.

- **In instances where TAC employees are otherwise engaged with appointments, are there procedures to allow taxpayers to schedule a future appointment while at the center?**

If a non-technical employee (greeter) is available, he or she can schedule an appointment for the taxpayer while the taxpayer is in the TAC. However, many of our one and two-person TACs do not have a greeter to provide this service. Therefore, we recommend taxpayers call the toll-free line for an appointment. Another benefit of calling the toll-free line is that the phone assistor may be able to resolve the taxpayer's issue over the phone. For example, in fiscal year 2017 (through April 22, 2017), phone assistors answered more than 2 million calls on the appointment scheduling line, and after speaking with assistors, only 43.7 percent of callers needed to schedule an appointment.

- **What type of review or oversight of TAC offices is performed to ensure TAC employees are fulfilling their mission and offering good customer service?**

To ensure TAC employees are fulfilling their mission and offering good customer service, we have managers on site to review service provided and other mechanisms, such as Field Assistance Contact Recording, which is a system to monitor TAC employee interactions with taxpayers. Managers also monitor their employees' appointment service calendars daily. Currently, with the appointment service, nearly 94 percent of taxpayers are waiting less than 30 minutes for service.

Senator Isakson

I appreciated your quick reply to my December 20, 2016, request to extend by 90 days the deadline for taxpayers to comply with the new reporting requirement in IRS Notice 2016-66, pertaining to micro-captive insurance transactions. As I noted in that letter, I believe it is important for the IRS to have time to consider taxpayer comments carefully and thoroughly before the new reporting requirement takes effect.

Following up on my previous request, I would like to know how the IRS has processed these taxpayer comments, which were due on January 30, 2017, as we approach the taxpayers' new reporting requirement deadline of May 1.

a) How many total comments were received?

We received 22 public comments and four congressional inquiries, including your December 20, 2016, letter. In addition to the comments of record, we met with every group that requested a meeting to discuss the application of the notice and hear their concerns.

b) Were there common underlying themes, concerns, or proposed changes recommended by taxpayers who submitted comments on the Notice?

We received several requests for extensions of time for filing required disclosure statements. In response, we issued Notice 2017-08 to provide a 90-day extension, until May 1, 2017, for taxpayers to file the disclosure statements identified in Notice 2016-66.

In general, taxpayers understood and supported the IRS's need to identify and stop abusive micro-captive transactions, but expressed concern that Notice 2016-66 is overbroad and burdensome. Comments also requested that the IRS consider modifying tax forms so that taxpayers may provide and the IRS may review this information in one place, avoiding any potential duplication. Finally, comments requested Notice 2016-66 be modified to exempt those captives that are currently under IRS audit from the disclosure requirements.

c) What process will the IRS use to respond to and, as appropriate, modify the reporting requirements based on legitimate concerns, issues, and proposals submitted by taxpayers?

We continue to review comments from the public about Notice 2016-66. To minimize the effect of additional disclosure requirements, we carefully crafted objective criteria in Section 2 of Notice 2016-66 that describe the type of micro-captive transactions that are subject to disclosure. To date, we have not received any comments that identified additional factors or industry standards that would further refine our objective factors. We will also consider the disclosures that we receive in response to the notice in determining whether to modify the reporting requirements to minimize taxpayer burden and limit potential disclosures of transactions that do not have the potential for tax avoidance.

Senator McCaskill

- 1. Due to a change in the law, the IRS will soon use private debt collectors to collect old tax debt. Does the IRS have staff who are trained and experienced at collecting taxes owed by ordinary taxpayers, and if so, why do we need to hire outside contractors to do this work?**

The Fixing America's Surface Transportation (FAST) Act requires the IRS to hire private debt collectors.

- 2. In 2015, you established the IRS Security Summit to address the explosion of stolen identity fraud in the online, do-it-yourself tax filings. As a result of that work, the private-sector tax industry, state tax agencies, and the IRS agreed to anti-fraud and security measures aimed at preventing and/or reducing stolen identity return fraud. As the Summit activity completes its second tax season, what measures have you taken to ensure that the anti-fraud and security measures adopted by current members of the Summit are expanded to all electronic tax software providers, including new entrants into the tax preparation market?**

As demonstrated by our signed Security Summit Memorandum of Understanding consisting of 41 state departments of revenue, 21 industry partners, and 9 endorsing organizations, we worked with industry and states to establish minimum trusted customer requirements for front-end customer identity authentication using recognized national standards from the National Institute of Standards and Technology (NIST) and the IRS Office of Safeguard. All e-file providers, including those currently in the program and those that are new entrants, must meet these requirements, which we review and strengthen annually. We updated Publication 1345, Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns, and Publication 3112, IRS E-File Application and Participation, to require industry e-file participants to perform due diligence data analysis and report suspicious activity to the IRS. We also updated and expanded the tax return data elements that we provide to software developers to strengthen the authentication protocols to verify that the real taxpayer is filing a tax return.

- 3. Federal law requires the government to provide a reward or compensation to a whistleblower of a percentage of all collected revenues in a successful prosecution, yet, the IRS limits rewards to a percentage of only back taxes collected. Can you explain why IRS policies do not conform to the statute?**

The collected proceeds for purposes of determining a whistleblower award are not limited to back taxes. Section 7623 of the Code describes "collected proceeds" as including penalties, interest, additions to tax, and additional amounts. Following public notice and comment, the Department of the Treasury and the IRS published final regulations that define "collected proceeds" to include tax, penalties, interest, additions to tax, and certain additional amounts collected. The regulations clarify, however, that collected proceeds are limited to amounts available to the Secretary of the Treasury for payment under the provisions of Title 26, United States Code.

Senator Thune

1. Identity Theft

One of the biggest issues facing South Dakotans when it comes to their federal taxes is the problem of tax-related identity theft. This not only affects those who have their identity

stolen, but also those who find their refund delayed while the IRS verifies their identity. While your testimony described a number of steps the IRS is taking to improve its defenses and help taxpayers fight ID theft, I have received reports from practitioners in South Dakota that some taxpayers are still waiting to resolve cases from last year and, as a result, still have not received their 2015 refunds. I have also received reports that even after a tax-related identify theft case is resolved, the taxpayer's future returns are held up and refunds are delayed.

- What steps is the IRS taking specifically to resolve identify theft cases faster, especially for taxpayers who are entitled to a refund?
- When a taxpayer has been the victim of tax-related identity theft and has been issued a PIN, does the IRS delay processing of returns and refunds in subsequent years when the PIN is included on the return? If so, what purpose does the PIN serve in helping to establish the taxpayer's identity?

Refund fraud caused by Identity Theft (IDT) is one of the biggest challenges facing the IRS today, and the harm it inflicts on innocent taxpayers is a problem we take very seriously. To resolve IDT cases faster, we centralized our IDT victim assistance policy, oversight, and campus case work under our new Identity Theft Victim Assistance (IDTVA) organization. Benefits to this centralized approach include managing work using a common inventory system, reducing hand-offs between functions, improved case processing through streamlined, consistent procedures, and improved communication. In addition, we resolve IDT cases faster using our toll-free hotline for IDT victims. All customer service representatives staffing this line are trained IDT specialists who can review the taxpayer's case file and respond to the IDT victim's call any time during business hours. For FY 2016, taxpayers who became IDT victims had their situation resolved, on average, in less than 120 days, a significant reduction from a few years ago when cases could take over 300 days to resolve.

The Identity Protection Personal Identification Number (IP PIN) protects taxpayers from subsequent tax-related IDT and will not delay the processing of returns and refunds if the IP PIN is included on the return. The IP PIN authenticates the return received is the taxpayer's real return. A delay in processing and refunds will occur if the IP PIN is not included on the return since we will have to authenticate the return received is the taxpayer's real return.

2. Taxpayer Assistance Centers

In your written testimony, you described at some length the success of the advance-appointment arrangement that the IRS has implemented at Taxpayer Assistance Centers (TACs). In particular, you pointed out that the advance appointments have been successful "because TAC employees can now spend more time with those [taxpayers] who do visit, as they tend to have more complex issue that cannot be resolved over the phone." Unfortunately, that conclusion is not consistent with reports my office has received from South Dakotans who have visited one of the TACs in South Dakota (in some cases driving more than 100 miles) only to be turned away because they were unaware that an appointment is required. And to add insult to injury, I have received reports that when

informed that they need an appointment, constituents have been told that they cannot use their cellphone while at the TAC to make such an appointment.

In general, the IRS has permitted visitors to bring personal cell phones with or without camera capability into TACs and other IRS facilities. However, the use of cell phones with camera capability raises security issues as it relates to the confidentiality and privacy of tax returns and related sensitive information. Therefore, while taxpayers may bring their cellphones into a TAC, the use of the phones inside a TAC is prohibited. Taxpayers may step outside the TAC office in the appropriate areas to call and make appointments.

- Is it true that a taxpayer can no longer seek assistance with a tax problem (other than needing a form or to pay a tax bill) at a TAC without an appointment?**

We are serving all taxpayers that come into a TAC without an appointment if we have the capacity to assist them in between scheduled appointments. We also serve individuals by exception in cases of hardships. For example, for the fiscal year through April 22, 2017, TAC employees served more than 253,000 taxpayers without an appointment. However, we recommend taxpayers call the toll-free line for an appointment to ensure they receive service at their requested time. A significant benefit of calling the toll-free line is that the phone assistor may be able to resolve the taxpayer's issue over the phone. For example, in fiscal year 2017 (through April 22, 2017), phone assistants answered more than 2 million calls on the appointment scheduling line, and after speaking with assistants, only 43.7 percent of callers scheduled an appointment.

- Are taxpayers turned away even if TAC employees do not have scheduled appointments and are available to provide assistance?**

We are serving all taxpayers that come into a TAC without an appointment if we have the capacity to do so in between appointments. Therefore, if employees do not have a scheduled appointment and are available to provide assistance, they will assist walk-in customers during this time.

- How does the IRS forewarn taxpayers that assistance is "by appointment only" at a TAC and prevent individuals from traveling long distances only to be turned away?**

We have issued several news releases throughout the year informing taxpayers that appointments are required to obtain service at the TAC, which many media outlets have picked up. This information is also available on IRS.gov and we placed it on the voicemail for local phone numbers for each TAC. Additionally, signs have been placed at each office location.

3. New Statutory Refund Delay

The PATH Act required that the IRS delay refunds until February 15th for returns that claim the Earned Income Tax Credit or the refundable child tax credit in order to reduce fraud and improper payments. Additionally, the PATH Act required employers to file their copies of Forms W-2, W-3 and 1099-MISC for non-employee compensation by

January 31st, rather than the end of February (or March if filing electronically) under prior law.

- **Can you share with the Committee any assessments of these new requirements and your efforts to reduce fraud and improper payments with respect to the EITC and refundable child tax credit more broadly?**

The PATH Act requirement that employers submit Forms W-2 to the government earlier than has been required in prior years allowed us, during the refund hold period, to use this earlier Form W-2 information in our Return Review Program (RRP), which identifies suspicious returns, to systemically verify taxpayers' wages and withholding. If the income information was inconsistent with the taxpayer's return, we selected the return for further review. This accelerated filing date of Forms W-2, together with the new requirements to hold EITC and refundable child tax credits, has improved our ability to identify incorrect or fraudulent returns. As a result, we identified 162,000 returns involving \$862.7 million for further review.

We continue to address improper payments through education, outreach, and compliance efforts. For example, we prevent more than \$2 billion in suspicious EITC claims from being paid each year through our fraud and identity theft prevention enforcement programs. We use sophisticated detection models and the early receipt of employer-provided income information in these programs. In addition, we protect between \$3 and \$4 billion in total revenue each year through additional EITC-related taxpayer compliance activities, one of which is our income document matching program. We also address paid preparer error through our EITC return preparer strategy that protects \$465 million in EITC and Child Tax Credits. We are creating a Refundable Credit Operational Strategy which will document our existing refundable credit efforts and identify potential new activities that could help address improper payments. We continue working with stakeholders to identify new opportunities. For example, we hosted an EITC Summit on June 29 and 30, 2016, to get different perspectives from our stakeholders on improving compliance while fostering participation.

- **How has the earlier availability of Forms W-2, W-3 and 1099-MISC for non-employee compensation enabled the IRS to improve its matching of tax data to reduce fraud and improper payments? Are there any specific results you can share with the Committee?**

The earlier availability enhances our defenses against identity theft and refund fraud and allows us to determine return consistency with known third-party reporting. As of February 16, 2017, the RRP received data for 220 million W-2 forms, compared to 97 million at that time last year. We held a total of 10.3 million returns for \$51 billion in refunds in accordance with the PATH Act provision to hold returns claiming the EITC or the Additional Child Tax Credit (ACTC) until February 15, 2017. Receiving earlier W-2 data and having additional time during the refund hold period allowed us to select additional returns for closer review that we otherwise would not have selected. As a result, we identified 162,000 returns involving \$862.7 million for further review.

- **Are other statutory changes needed to help the agency stop improper refunds before they go out the door?**

While the PATH Act provisions helped us to administer refundable credits, further statutory authority is needed. Currently we lack the statutory authority to address at the time of filing errors due to claims in excess of lifetime limitations and lack of required documents. Instead we must address these errors through the audit process, which is a lengthier process that requires significant resources. For example, without an audit, the IRS cannot address claims for the American Opportunity Tax Credit (AOTC) where a student has been claimed for more than the four-year limit, has attended an ineligible institution, or did not attend at least half-time. Granting the IRS the authority to correct specific errors at filing, for example allowing the IRS to address claims for AOTC for students attending ineligible institutions or claiming the AOTC for more than four years, would increase our ability to address more of the fraud and errors we identify and help decrease improper payments from refundable credits. Taxpayers would still have all of their rights protected since they could disagree with our information, provide additional documentation, and appeal any adverse decision.

Additionally, since paid preparers prepare more than half of the returns that are filed for refundable credits, providing the Treasury Department with authority to regulate all tax return preparers would enable Treasury to require them to meet minimum competency standards through testing and continuing education requirements and would help promote higher quality service, improve voluntary compliance and foster taxpayer confidence in the fairness of the tax system. This will benefit all taxpayers including those claiming refundable credits.

The FY 2018 budget included proposed legislative changes for greater flexibility to address correctable errors and increased oversight of paid preparers.

Senator Warner

1. **In 2015, you announced the Security Summit, a partnership between the IRS, States, and members of the tax filing industry to help address rampant issues with identity theft. What new improvements has the Summit implemented for the 2017 filing season, and what steps is the IRS taking to ensure broad industry participation in the Security Summit?**

For the 2017 filing season, the IRS and Summit partners took additional actions to identify and stop fraudulent ID theft returns including the following:

- We updated and expanded authentication data elements transmitted by the tax industry with every tax return. We added 37 new data elements for 2017, providing additional information to strengthen the authentication protocols that verify the real taxpayer filed a tax return.
- The tax industry is sharing with the IRS and states approximately 30 data elements from business tax returns (Forms 1120, U.S. Corporation Income Tax Return; 1065, U.S. Return of Partnership Income; and 1041, U.S. Income Tax Return for Estates and Trusts)—extending more identity theft protections to

business filers, as well as individuals.

- More than 20 states are working with the financial services industry to create their own version of a program that allows the industry to flag suspicious refunds and return those funds. Also, private sector partners are enhancing efforts to identify the “ultimate bank account” to ensure that the refunds go into the true taxpayers’ accounts.
- The Form W-2 Verification Code initiative started by the IRS last year expanded to 50 million forms in 2017 from two million in 2016. This initiative requires individuals and tax professionals to enter a verification code when prompted to do so by tax software in order to validate the information on the Form W-2, helping to protect against the filing of false Forms W-2.
- The software industry continues to enhance software password requirements for individuals and tax professional users – providing additional safety prior to filing.
- The Summit team continued outreach campaigns such as “Taxes. Security. Together.” to encourage taxpayers to protect their personal information. The team held a National Tax Security Awareness Week in December that provided daily tax tips/fact sheets to educate taxpayers and tax preparers about security awareness. The team also launched a “Protect Your Clients; Protect Yourself” campaign aimed at increasing security awareness among tax professionals.
- The new Identity Theft Tax Refund Fraud Information Sharing and Analysis Center pilot began on January 23, 2017. This serves as an improved early warning system identifying emerging identity theft schemes and quickly sharing that information among Summit partners so that all participants can enact safeguards.

We are continuing our collaborative efforts with our partners to enhance and expand our anti-fraud and security measures. For example, the Security Summit partnership now consists of 41 state departments of revenue, 21 industry partners, and 9 endorsing organizations. In addition, the National Society of Tax Professionals (NSTP) and National Society of Accountants (NSA) are newly active Summit partners. For returns filed in 2016 (tax year 2015), our Security Summit partners filed 99.6 percent of the total accepted filed returns. The Security Summit’s endorsing agencies represent a wide range of industry participants from software firms, nationally branded tax preparation companies, financial services companies, payroll professionals and tax practitioners.

This collaboration, and the continued work by IRS employees to improve our filters, resulted in a 46% decrease from 2015 to 2016 in the number of taxpayers identifying themselves as victims of identity theft.

- 2. I remain concerned about the lack of minimum standards for paid return preparers and the identity theft issues that result from unscrupulous preparers. Is the IRS seeing an increase in tax-related identity theft cases or other tax refund issues that**

can be tracked to these unregulated tax return preparers? How would licensing paid return preparers reduce instances of identity theft?

Tax return preparers have increasingly become targets for identity and data thieves given the vast amount of personal and financial information made available to them by taxpayers. Subjecting tax return preparers to minimum standards gives the IRS more opportunities to provide directed outreach and education to the preparer community about issues such as identity protection and data and system security. Requiring minimum standards for return preparers would also help the IRS with identifying unscrupulous preparers and developing more effective compliance and enforcement strategies.

3. I know that over the last several years, the IRS has been operating under a drastically reduced budget, making it more difficult to both effectively serve taxpayers and modernize your systems to address the challenges of an increasingly digital economy. What are the top IT modernization challenges that you face when not fully funded? How are cybersecurity efforts being hampered by your current budget?

Our top IT challenges are cybersecurity, aged infrastructure, skilled resources and unmet demand. Our cybersecurity threat is ever changing. We are battling sophisticated organized crime syndicates around the world, and the solutions we implemented as little as a year ago are starting to become obsolete, requiring us to come up with new solutions that need additional funding. Further, specialized skills in this area are very hard to obtain and hiring freezes as a result of our budget constraints are making it nearly impossible to hire staff to support all the changes needed; in particular, the safeguarding of our high value assets. To fund these challenges, in 2017, in addition to base resources, we have directed up to \$130 million in reprogrammed funds to these critical needs.

Our aged infrastructure not only presents a security risk, but also jeopardizes our ability to deliver the mission effectively and efficiently. Costs are driven up with increased outages, need for expensive manual workarounds, increased support costs, increased dependency on contractors for support, and more. Presently, over 60% of our hardware and 30% of our software are out of date.

People resources continue to be the biggest obstacle to IT modernization including delaying some modernization projects. Quite simply, there are not enough IRS technologists and subject matter experts to deliver on our modernization plans. Over the last few years, many highly-skilled, brilliant lead technologists on our IT programs have left. With approximately 25 percent of IT employees eligible to retire by the end of FY 2017 and approximately 40 percent by the end of FY 2019, the significance of this challenge cannot be overstated.

4. In the past, I have communicated with the Agency regarding the unique challenges that on-demand workers may face when filing their individual income tax returns. Last year, the IRS implemented its Sharing Economy Resource Center. Has the Agency received feedback on that Resource Center? Does the Agency have further

plans to ensure that this population of taxpayers is receiving the appropriate services and guidance to meet their tax filing obligations?

The IRS recognizes the need to provide information and continue to monitor the communication needs related to the sharing economy, both for employees and employers. We launched the Sharing Economy Resource Center on IRS.gov in August 2016, and we have received positive comments about the center and our continuing communications efforts from the tax community as well as others involved in the sharing economy. We have been particularly active in this area with our communication products, sharing information through traditional media and social media channels, including Twitter, as well as sharing information with tax professionals and our stakeholder partners. Our communication efforts will continue in this area, and we will continue to look for ways to address additional needs for information on tax issues in the sharing economy. The Treasury Department is unable to provide any specific guidance on an individual's status as an employee or independent contractor because Section 530(b) of the Revenue Act of 1978 prohibits formal written guidance on the issue of worker classification.

5. I understand from your testimony that the IRS' Data Retrieval Tool is not expected to be restored for use until October 2017. I appreciate that privacy and data security are paramount, and support your efforts to prioritize these things.

- What are the specific additional security measures that you anticipate needing to put in place before you feel confident restoring the tool?**

Before restoring the Data Retrieval Tool (DRT), we need to implement a data encryption or a "locked briefcase" solution. This would be the equivalent of handing the taxpayer a locked briefcase that they would be able to hand to the Department of Education, but not have the key to open and look inside. The Department of Education however would be able to open the briefcase, but not display the data to the taxpayer. We will also need to send notice to the taxpayer's address of record whenever they use the DRT indicating that their tax information was accessed in order to confirm that the true taxpayer, and not identity thieves, initiated the transaction.

- What costs do you anticipate being associated with these efforts?**

The development costs for our IT system changes are approximately \$100K. The IRS is reviewing the longer-term costs of providing notices to the taxpayers and any associated taxpayer support.

- What do we know now about the extent of hackers' infiltration? What questions remain unanswered?**

We know that access was facilitated by obtaining high quality Personally Identifiable Information (PII) from a non-IRS source. We also know that access was limited to the PII of each individual identity, as there was a one-to-one match on the access. This means the

perpetrators were not able to move around the system, and the system was not “hacked” in the technical sense of the word. Rather, an impersonation of the taxpayer occurred.

What remains unanswered is where the impersonator obtained the high quality PII. Both IRS and Treasury Inspector General for Tax Administration criminal investigations are underway and would need to conclude to determine the exact origin of the PII. However, high quality PII is readily available on the “dark web” for fraudulent activity.

**SENATE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
QUESTIONS FOR RECORD FOR IRS COMMISSIONER JOHN KOSKINEN**

Hearing on Fiscal Year 2018 Budget Request
From the Department of the Treasury
July 26, 2017

Questions from Sen. Thad Cochran:

1. Commissioner Koskinen, in your opening statement you mentioned that the Internal Revenue Service (IRS) is gradually transitioning towards online services to assist citizens. Many of my constituents do not have access to computers or broadband service, especially in rural areas of Mississippi. What is the IRS doing to ensure taxpayers are not adversely affected by the IRS's focus on online services? Please provide the Committee with data from the previous three fiscal years about the number of in person and phone interactions the IRS has conducted with taxpayers. Additionally, what is the average wait time for taxpayers to reach an IRS employee through in person visits or phone interactions? Does the IRS plan to transition to online services only? If so, please provide a timeline and details of such plan.

Response: 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 digital services, or who simply prefer not to conduct their transactions with the IRS online.

Consequently, we remain committed to providing the services these taxpayers need. While we will continue to offer more web-based services, taxpayers will still be able to call our toll-free lines, write to us, or obtain in-person assistance, if that is how they want to interact with the IRS. In fact, we believe that providing more online services for those who want them will free 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.

The tables below provide the metrics requested for the previous three fiscal years.

Wage & Investment Phones	FY 2014	FY 2015	FY 2016	FY 2017 through July
Average Wait Time	19 min	30 min	17 min	8 min
Total number of Calls Answered (assistor and automated)	63.9 million	55.7 million	63.8 million	47.3 million

Taxpayer Assistance Centers	FY 2014	FY 2015	FY 2016	FY 2017 through July
Total Number of Face-to-Face Contacts	5.5 million	5.4 million	4.4 million	2.8 million
% of customers waiting 30 minutes or less **	75%	68%	73%	94%

** Beginning in 2015, we started offering service by appointment at a small number of Taxpayer Assistance Centers (TACs). In FY 2017, all IRS TACs offered service by appointment.

2. Commissioner, the understaffing and closure of Taxpayer Assistance Centers (TAC) has been a cause of concern for this Committee. In Fiscal Year 2017, this Committee directed the IRS to hold public forums and notify the Senate and House Committees on Appropriations before closing a TAC. Will you share with the Committee what the IRS is doing to analyze the impact of closing a TAC? Describe how the agency determines the impact in rural areas. What metrics is the IRS using when deciding to close a TAC? Describe the process that the IRS uses to notify communities of TAC closures.

Response: To best use our resources and to meet the demand for services in our Taxpayer Assistance Centers (TACs), in 2015 we started offering service by appointment in a small number of locations. We received favorable taxpayer response, and expanded the pilot. In FY 2017, all of our TACs offered service by appointment. As each traditional TAC location comes under review, we compile data to determine the most efficient methods to meet taxpayer face-to-face service needs. For example, we have a service strategy that considers items such as the services most requested by taxpayers at the TAC location, available staffing, proximity of the next closest TAC, availability of a partner to provide virtual assistance, availability of Voluntary Income Tax Assistance and Tax Counseling for the Elderly locations, and local demographic information.

If the IRS makes a tentative determination to change the method of providing service (either through moving the TAC location or changing from one service-delivery method to another—such as to virtual assistance provided by a community partner), we will invite taxpayers in the community to provide input in the decision-making process. Should the data and preliminary public comments suggest that face-to-face service is no longer required through any service channel, we would schedule a formal public hearing to obtain further public comment. We would follow the public hearing process with a report to oversight agencies, as requested in previous and current committee reports.

We routinely review locations to promote more efficient use of the government's real estate assets and to comply with Executive Orders, OMB directives, Federal Acquisition Regulations administered by the General Services Administration, and congressional mandates regarding real estate. This review includes evaluating

small, mid-size, and large posts-of-duty with a high percentage of vacant workstations, a high number of field-based employees, and space reduction projects initiated because of lease expirations, relocations, review of training space needs, and other reasons. During these reviews, we analyze taxpayer access to face-to-face service in the community and determine how to effectively meet taxpayer needs and preferences for service.

3. Commissioner, I am pleased to hear that the number of tax-related identity theft has declined in the past two years. The Taxpayer Advocate Service has recommended that constituents with multiple identity theft issues be assigned one point of contact at the IRS to assist them until the resolution of their case. What is the IRS doing to help simplify assisting taxpayers affected by identity theft? Has the IRS taken this proposal into consideration? When does the agency plan to implement this proposal?

Response: Our work on identity theft (IDT) and refund fraud touches nearly every part of the organization. Helping victims and reducing the time it takes to resolve cases is a top priority for the IRS.

During 2015, the IRS centralized IDT victim assistance policy, oversight, and campus case work into a new Identity Theft Victim Assistance (IDTVA) organization within the Wage and Investment (W&I) Division. IDTVA can work IDT cases from beginning to end, providing an improved taxpayer experience.

In the victim assistance area, we have reduced the time it takes to resolve a case. For most cases, the average time is now less than 120 days, but for more complex cases, resolution can take up to 180 days. This timeframe is substantially less than a few years ago, when cases could take over 300 days to resolve. While this change marks a significant improvement, we continue to look for ways to shorten this time and ease the burden IDT places on these taxpayers.

Whenever possible, the same employee processes multiple claims (often for multiple years) from the same taxpayer, to make sure there is consistent processing. In January 2015, the IRS developed automation to associate IDT documentation with existing IDT cases/category codes. In April 2016, we expanded the programming to include the association of documentation with new categories of work resulting from the centralization effort under the IDTVA organization.

Centralization of IDTVA work significantly affected our ability to resolve those cases more quickly. Since implementation, we resolve those cases in less than 120 days 75 percent of the time, compared to 34 percent prior to implementation.

Our toll-free hotline for IDT victims helps taxpayers reach a trained IDT specialist any time during business hours, without having to rely on the availability of a single IRS employee. Customer service representatives staffing this specialty line can review the taxpayer's case file and respond to the IDT victim's call. While we believe

this approach provides the best possible experience for the victim, we are aware that sometimes the customer service representative cannot respond to the IDT victim's call. For these instances, beginning on August 1, 2017, we implemented a process for IDT victims to have direct contact with the employee working their IDT cases. The customer service representative will provide the IDT victim with a different toll-free number to call to directly contact the employee working his or her case. If the employee is unavailable to answer the IDT victim's call, the victim can leave a message for the employee, and the employee will return the victim's call within five business days. In addition, we expanded procedures to provide a single point of contact when a victim's case spans multiple years.

SUBMITTED BY SENATOR BOOZMAN

Q. Commissioner Koskinen, I would like to discuss taxpayer services. There have been reports citing a continuing decline in the level of service that IRS provides to taxpayers, especially those who are victims of stolen identity refund fraud. Additionally, we have heard of increasing wait times for taxpayers contacting IRS, and a rise in the use of "courtesy disconnects" - hanging up on a customer after an excessive wait time. What has your office done to remedy this, and going forward, what plans does your office have to improve on customer service and taxpayer assistance?

Response: We have had many notable achievements for 2017 in terms of improving the level of service provided to taxpayers on the calls the Wage and Investment (W&I) Division handles. Congress specifically appropriated additional funding to help the IRS improve customer level of service (LOS). This additional funding, along with effective planning and monitoring, allowed W&I toll-free phone operations to deliver a filing season telephone LOS of over 79 percent - the highest telephone LOS since 2007. This change is an increase over the 72.1 percent achieved in this same timeframe in 2016. The 2017 fiscal year LOS is at 76.7 percent through the beginning of August, a substantial improvement over the 53.4 percent in 2016. We are on pace to have the best FY LOS in 10 years.

In the IDT victim assistance area, we have reduced the time it takes to resolve a case. For most cases, the average time is now less than 120 days, but for more complex cases, resolution can take up to 180 days. This timeframe is substantially less than a few years ago, when cases could take over 300 days to resolve. In addition, we continually improve our efforts to stop fraudulent refunds from being paid. For example, we have improved the filters that help us spot suspicious returns before we process them. The number of people reporting to the IRS that they were victims of IDT declined from 698,700 in calendar year (CY) 2015 to 376,500 in CY 2016 – a 46 percent drop. This downward trend has continued into 2017.

	Taxpayer Assistance Toll-Free Line Fiscal Year LOS	Taxpayer Assistance Toll-Free Line Filing Season LOS
FY 2007	82.08%	83.46%
FY 2008	52.81%	77.41%
FY 2009	70.02%	63.97%
FY 2010	74.04%	75.28%
FY 2011	70.07%	74.64%
FY 2012	67.55%	68.31%
FY 2013	60.50%	70.12%
FY 2014	64.39%	70.88%
FY 2015	38.10%	37.28%
FY 2016	53.43%	72.11%
FY 2017		79.12%

Through April, filing season (FS) average speed of answer (ASA) (wait time) was six and a half minutes on the taxpayer assistance toll-free line. This wait compared to 11 minutes in FS 2016 and 23 minutes in FS 2015, and reflects a decrease of 16 ½ minutes. During this same period, disconnects (calls terminated due to a lack of system or assistor resources) were 834,000 compared to 1.3 million in FS 2016 and 8.8 million in FS 2015, a 90 percent (almost 8 million) decrease. Call volume was also a factor in delivering a higher LOS. By implementing robust communication and outreach strategies for filing season initiatives, the IRS successfully brought awareness to taxpayers and partners about key changes and programs, and equipped them to take any action needed timely. These efforts greatly diminished expected inquiries from taxpayers, media, and oversight resulting in reduced impact on operations and demand on customer service.

The IRS also provides telephone assistance to other groups of taxpayers, such as to taxpayers responding to a notice received in the mail. Those phone lines may provide a different level of service than the toll-free assistance line and reflect our resource challenges.

SUBMITTED BY SENATOR CHRIS COONS

1. Electronic Tax Return Filing – Business Returns

Over the past decade, the rate for electronic filing of individual tax returns grew exponentially from 54% in 2006 to 86.4% in 2016. In the recent 2017 filing season, 90% of individual returns were submitted electronically. In contrast, in 2016, only 50% of the nearly 30 million business returns were electronically filed. The IRS

FY18 budget justification indicates that the business e-filing target will increase to 51% for FY17 and to 52% for FY18.

- Can you elaborate on this phenomenon and explain what the IRS is presently doing or planning to do to improve the e-filing rate for business returns?
- Is there a rational basis for not setting more ambitious targets as an incentive to achieve a higher rate?
- Are there any particular advantages for a business taxpayer to file electronically?

Response: Our greatest challenge to achieving e-file increases in business returns is the employment tax series (Form 94x). This family of forms represents the greatest overall volume of business forms, and therefore the greatest opportunity to increase overall e-filing of business returns. During the past seven filing seasons, the Form 94x series e-file rate has consistently seen the slowest or close-to-slowest growth of all major return types. In 2015, the IRS released a Federal Register request for comments on ways to increase the electronic filing of employment tax returns. The digital signature process was highlighted in the responses received as a key barrier to increasing e-file rates across these returns. We are evaluating the development of a Form 94x online signature preparer identification number (PIN). After removing this key barrier, we will pursue a means to offer free or low cost 94x e-file solutions with the goal of driving greater e-filing of this high-volume family of forms.

We process e-file returns faster and with fewer errors. For taxpayers, this means quicker refunds and less contact with the IRS. IRS e-file provides proof of receipt within 24 hours of sending returns to the IRS. Individuals and businesses can e-file balance due returns and schedule an electronic funds transfer (EFT) from their account for any date.

2. Impacts of Proposed Cuts – Diminished Services for Taxpayers

The Trump budget request for the IRS of \$10.975 billion is expected to take a toll on the ability of the IRS to respond to taxpayers' telephone calls. In the budget justification materials submitted to Congress, the IRS states that the resources made available in 2016 supported a 53.4 percent Level of Service (with a 72 percent level during filing season which included a seasonal workforce). For 2017, a target LOS of 64 percent is specified, with the most recent filing season achieving a 79 percent service level. But the IRS then projects a 39 percent target for 2018, even with a planned infusion of \$58 million in user fees to augment appropriated dollars.

- Commissioner Koskinen, providing access to quality customer service helps taxpayers understand their obligations so they can pay the right amount on time. It is important for me that hard working Delawareans are able to readily

obtain assistance they need to act in good faith and pay the taxes they owe. That's why the 2018 service target of 39 percent deeply concerns me, particularly given that the IRS has, to its credit, made significant strides to turn around an abysmal level of service recorded for 2015, when only 38 percent of 100 million calls were answered and experienced an average waiting time of 30 minutes?

- Do you think it is acceptable to provide a level of service where as many as 6 of 10 callers will not likely be able to connect to an account representative or will be forced to spend inordinate amounts of time waiting on hold? As Commissioner, what do you consider to be an "acceptable" level of service for taxpayers calling on the toll-free phones?
- Is it conceivable that the IRS could ever achieve the level of service experienced in 2004 when the IRS answered 87 percent of phone calls with an assistor and waiting times averaged just 2.5 minutes?
- What amount of funding would the IRS require in fiscal year 2018 in order to sustain this year's results where there's a 64 percent general target and a 79 percent service level during the filing season?

Response: I consider an acceptable level of service (LOS) to be approximately 70 percent or above. Delivering a LOS much higher than 80 percent can result in inefficiencies as our call site assistors could wait extended periods of time for the next call. Funding for Taxpayer Services is just one of many variables that influence the LOS. Call volume, often driven by external events such as the enactment of tax legislation, and the availability and reliability of IRS technology infrastructure, are other major factors the IRS would have to consider before committing to new targets.

3. Combating Tax Scams and Identity Thieves

In recent years, thousands of people have lost millions of dollars and their personal information to tax scams and fake IRS communication. Scammers use the regular mail, telephone, fax or email to set up their victims and regularly alter their tactics to perpetrate crimes in new ways. Even tax professionals are being targeted by identity thieves. On July 11, the IRS announced a new "Don't Take the Bait" awareness campaign aimed at tax professionals who may be vulnerable to sophisticated spear-phishing cybercrimes.

- What resources is the IRS devoting to fighting tax scams? Have successful prosecutions of scammers provided any measurable deterrent effect?

Response: We have devoted significant resources to fighting tax scams and our work has had a measurable effect. The prosecutions by India and the United States resulted in a measurable drop in calls by scammers. Initially, the number of calls reported to TIGTA dropped from 40,000 a week to 1,000 a week. Unfortunately, the

number of calls reported to TIGTA is creeping back up to 7,000 a week, indicating that we still have a problem.

The Criminal Investigation (CI) Division, specifically, continues to devote significant resources in the battle against Tax Related ID Theft. In FY 2017, as of July 31, CI has dedicated 13.9 percent of its direct investigative time to this effort representing over 295,000 investigative hours. During that time, CI initiated over 300 new investigations and over 450 identity thieves were sentenced. Additionally, CI has worked with partners within the IRS Security Summit to focus outreach efforts addressing the emerging schemes targeting tax professionals and payroll service providers. Examples of these efforts include generating a YouTube video warning tax professionals of the need to maintain an Information Security Plan, delivering presentations at regional and national conferences, and working with private sector entities within the tax eco-system to enhance information security. CI also works closely with IRS operating divisions to ensure data losses involving tax preparers and payroll service providers receive enhanced screening for ID Theft. As of August 17, 2017, CI forwarded information on over 431 incidents involving data losses that affected 372,776 taxpayers.

CI has noticed a downward trend in the street level crime. However, it has seen an increase in sophisticated and complex computer intrusions, spear phishing, and remote accesses takeovers that resulted in high consistency Stolen Identity Refund Fraud. As a result, IRS CI will continue to provide RICS (Return Integrity & Compliance Services) with updated information and personal identifying information for revenue protection.

- What additional measures would help the IRS to better detect fraud and halt refund fraud schemes in their tracks?

Response: Several additional measures would help us to better detect fraud and halt refund fraud schemes. Combating the sophisticated criminals committing identity theft is a never-ending process that requires significant resources. Over the last several years, we have made steady progress against identity theft thanks to the collaborative efforts of the Security Summit. This strong, unique partnership between the public and private sectors has allowed us to coordinate efforts on many different levels and put in place many new and productive safeguards. These efforts to date have significantly affected the tax ecosystem. We continue to devote significant time and attention to this challenge and are committed to doing all that we can to prevent the payment of fraudulent refunds, pursue the perpetrators, and assist the victims.

While the PATH Act provisions are assisting us in effectively administering refundable credits, we need further statutory authority. Currently, the IRS lacks statutory authority to address, at the time of filing, claims in excess of lifetime limits and the lack of required documentation. Instead, we must address these errors through audits, which takes longer and requires more resources. Granting the IRS the authority to correct such errors at filing (correctable error authority) would

increase our ability to address more of the improper claims and errors we identify and decrease improper payments of refundable credits. We requested this additional authority in the 2018 Budget.

In addition, since paid tax preparers prepare more than half of the returns filed for refundable credits, requiring them to meet minimum competency standards, through testing and continuing education, would help promote high quality services from paid tax preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. This requirement would benefit all taxpayers, including those claiming refundable credits. We requested this additional authority in the Administration's 2018 Budget.

- Is the IRS working in conjunction with other Federal agencies, such as the Federal Trade Commission and the U.S. Postal Service, to alert consumers?

Response: We conducted an extensive consumer education effort on tax scams and schemes for several years, making it a key part of filing season information for taxpayers, as well as a central component of communications work in the Security Summit effort. The Summit, a joint project between the IRS, state tax agencies, and the private-sector tax industry, has highlighted Identity Theft (IDT) and tax scams in joint communications since 2015. This outreach effort has included working with numerous private-sector partners as well as government agencies, including the Federal Trade Commission (FTC). We have actively participated for several years with the FTC's identity theft efforts, participating in panels, issuing joint communications, and sharing information on their respective websites. For example, the IRS participated in FTC IDT awareness weeks in January 2016 and 2017. Similar communications efforts have been made with dozens of state tax agencies participating in the Security Summit.

- To what extent is IRS working with paid preparers and the software industry to leverage their resources and share information about emerging threats? What are your expectations of the recently launched "Don't Take the Bait" campaign?

Response: We chartered the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center (IDTTRF-ISAC) in December 2016 and began pilot operations at the start of this filing season on January 23, 2017. The IDTTRF-ISAC is a natural result of our Security Summit activities, which began in 2015 to look holistically at the tax refund IDT problem across the lifecycle of a tax return. The purpose of the IDTTRF-ISAC is to share IDT tax refund fraud information, data, and related analysis with public and private entities to detect, prevent, and deter IDT tax refund fraud. As of late April 2017, the IDTTRF-ISAC has 36 member organizations from state departments of revenue and tax software and tax preparation industries. The two primary capabilities being piloted this year are: sharing of tax ecosystem alerts and analyzing leads generated by the tax software and tax preparation industry, as well as other member data.

Tax ecosystem alerts are akin to a neighborhood listserv for the tax ecosystem. Members report and share tax ecosystem threats they encounter so that others can protect themselves against the same or similar threat. Past threats have included employer W-2 breaches, compromised return preparers, new schemes, and dark web chatter about system vulnerabilities. Because of Security Summit workgroup efforts, we are preventing more identity theft this year than last year, we are detecting fewer fraudulent refund claims, and fewer people are reporting that they have become tax-related identity theft victims. The IRS continues to prevent more fraudulent refunds at the door, which has a cascading effect on individuals reporting they've become victims of identity theft. The number of people reporting to the IRS that they were victims of IDT declined from 698,700 in calendar year (CY) 2015 to 376,500 in CY 2016 – a 46 percent drop. This downward trend has continued into 2017.

We have also worked with state and industry participants to implement a Rapid Response team for the efficient communication of emerging threats. These alerts are shared with partners and in the ISAC functionality.

We designed the “Don't Take the Bait” campaign to warn tax professionals to beware of spear phishing emails, a common tactic cybercriminals use to target practitioners. The expectation is that practitioners would become more aware of the types of cyber security threats facing their businesses and clients. This awareness should also lead to the establishment or improvement of cybersecurity plans to protect taxpayers and the IRS from the loss of critical personally identifiable information. We have been pleased at the significant media coverage thus far to our weekly releases warning against various threats to the public, tax preparers, and businesses.

4. Improving Services for Tax Refund Fraud Victims

For several years, the National Taxpayer Advocate has endorsed an approach that would assign a single designated IRS account representative to tax-related identity theft and refund fraud victims to help navigate the case through the process from intake through disposition and maintain control of the taxpayer's case. This would improve the current scheme whereby an already frustrated victim has to often speak with multiple different assistants and frequently has to re-explain or resubmit their cases.

- What consideration is the IRS giving to the National Taxpayer Advocate's proposal to assign a designated IRS account representative to victims of tax refund fraud for consistent service from intake to disposition? Why is such an approach not feasible or preferable?
- What other steps has the IRS taken to improve the handling of tax refund fraud and identity theft and with what results?

- What more should be done to assist victims?

Response: Our work on IDT and refund fraud touches nearly every part of the organization. Helping victims and reducing the time it takes to resolve cases is a top priority for the IRS.

During 2015, the IRS centralized IDT victim assistance policy, oversight, and campus case work into a new Identity Theft Victim Assistance (IDTVA) organization within the W&I Division. IDTVA can work IDT cases from beginning to end, providing an improved taxpayer experience.

In the victim assistance area, we have reduced the time it takes to resolve a case. For most cases, the average time is now less than 120 days, but for more complex cases, resolution can take up to 180 days. This timeframe is substantially less than a few years ago, when cases could take over 300 days to resolve. While this change marks a significant improvement, we continue to look for ways to shorten this time and ease the burden IDT places on these taxpayers.

Whenever possible, the same employee processes multiple claims (often for multiple years) from the same taxpayer to make sure there is consistent processing. In January 2015, the IRS developed automation to associate IDT documentation with existing IDT cases/category codes. In April 2016, we expanded the programming to include the association of documentation with new categories of work resulting from the centralization effort under the IDTVA organization.

Centralization of IDTVA work enabled full capabilities to use the Correspondence Imaging System in handling the IDT cases with current or past compliance activity. This change has significantly affected our ability to resolve those cases more quickly. Since implementation, we resolve those cases in fewer than 120 days 75 percent of the time, compared to 34 percent prior to implementation.

Our toll-free hotline for IDT victims helps taxpayers reach a trained IDT specialist any time during business hours, without having to rely on the availability of a single IRS employee. Customer service representatives staffing this specialty line can review the taxpayer's case file and respond to the IDT victim's call. While we believe this approach provides the best possible experience for the victim, we are aware that sometimes the customer service representative cannot respond to the IDT victim's call. For these instances, beginning on August 1, 2017, we implemented a process for IDT victims to have direct contact with the employee working their IDT cases. The customer service representative will provide the IDT victim with a different toll-free number to call the employee working his or her case directly. If the employee is unavailable to answer the IDT victim's call, the victim can leave a message for the employee, and the employee will return the victim's call within five business days. In addition, we expanded procedures to achieve a single point of contact when a victim's case spans multiple years.

5. Restoring IRS Streamlined Critical Pay Authority

As part of the 1998 restructuring of the IRS, Congress authorized some unique special personnel flexibilities to help the IRS recruit and retain highly skilled employees with specialized expertise. “Streamlined critical pay authority” permits the IRS to bring in up to 40 uniquely qualified experts for 4 year appointments to revitalize and enhance the IRS workforce. The original authority had a 10 year sunset and was renewed in the FY2008 FSGG bill for 5 additional years, but has now lapsed as of September 30, 2013. The President’s FY18 budget seeks language to reinstate the authority.

- I understand that other than addressing funding requirements, one of the IRS’s top priorities for the FY18 appropriations cycle is the reinstatement of streamlined critical pay authority. How has the IRS used streamlined critical pay authority and what have been the primary benefits?
- What types of positions has this authority enabled the IRS to fill?
- What are the ramifications if this now-expired authority is not renewed?

Response: Since its inception under the Restructuring and Reform Act of 1998 (RRA ’98), the IRS has found the Streamlined Critical Pay (SCP) authority to be an enormously valuable tool in recruiting top tier talent from private industry. The tool has been particularly valuable in recruiting for positions in the Information Technology (IT) organization where external talent has contributed greatly to our keeping pace with the technological advances needed to provide world class service to the American taxpayer. We have used the authority to recruit individuals with specific expertise in sensitive, high-level initiative areas such as:

- IT Engineering
- IT Architecture
- Cybersecurity
- Online/Web Services

In addition to being a useful tool in Information Technology, the hiring authority has also been invaluable in helping to fill positions in sophisticated and complex areas of international taxation, risk management, and data analytics. Because the IRS has not been able to approve new SCP appointments since the authority expired on September 30, 2013, we have lost all SCP appointees through either appointment expiration or separation.

The incumbents were sitting in technical, highly-specialized positions where internal successors with the requisite skills to fill the position are not readily available to backfill behind the SCP appointee. Reinstating the SCP authority would allow us to recruit and hire other highly-specialized executives for critical positions to help deliver our mission and achieve modernization. To remain with the IRS absent SCP

authority, SCP appointees would have to competitively apply to an open Senior Executive Service (SES) vacancy announcement and obtain SES certification from the Office of Personnel Management (OPM) prior to the end of their appointment. This process can take upwards of six months to complete. To bring their salary in line with the pay cap limitations set under the Executive Schedule, SCP appointees would incur a significant pay cut to their annual rate of basic pay by 20 to 30 percent. Due to each appointee's high-level of expertise and technical abilities within his or her related fields, each will be more than capable of obtaining salaries and compensation packages far exceeding IRS's capabilities in the private sector.

The SCP authority allowed the IRS to hire top-caliber executives under an abbreviated timeline. Once a candidate has accepted an SCP position, IRS can bring the individual on-board within four to six weeks. This includes time to complete the required background and tax checks, as well as allowing the individual to provide sufficient notice to his/her current employer. In rare cases, due to the critical nature of the position, IRS on-boarded a SCP appointee in as few as two weeks.

This streamlined hiring capability was crucial in recruiting highly-skilled professionals. Particularly in the information technology and cybersecurity fields, the demand for top recruits can be so aggressive that a speedy hiring process, along with a competitive compensation offer, can be the difference between hiring a "game changing" executive and losing one to a competitor in either the public or private sector. Additionally, the SCP authority allows the Commissioner to set pay up to, but not exceeding, the Vice President's salary. This flexibility allows the IRS to attract candidates we would normally not be able to reach due to the pay limitations under the Executive Schedule.

We used the SCP authority for 171 appointments between October 1, 1998, and September 30, 2013, when the authority expired. The IRS has three SCP executives on-board; the last of whose term will expire on September 29, 2017. Since SCP was extended in 2008, the number of SCP positions has ranged between three (as of August 17, 2017) and 30 (March 2010).

6. IRS Management and Performance Challenges for Fiscal Year 2017

Each year, the Treasury Inspector General for Tax Administration (TIGTA) evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerabilities to the Nation's tax system. On October 6, 2016, TIGTA issued its assessment enumerating the top ten management challenges for 2017. The number one priority challenge TIGTA cited is security over taxpayer data and protection of IRS resources.

TIGTA reported that while the IRS recognizes the growing challenge it faces in establishing effective authentication processes and procedures, the IRS has not established a service-wide approach to managing its authentication needs. Consequently, the level of authentication the IRS uses for its various services is not

consistent. TIGTA emphasized that while the IRS is evaluating potential improvements to existing authentication methods to prevent identity theft, the IRS is not developing overall strategies to enhance authentication methods across IRS functions and programs.

- Mr. Koskinen, what are your perspectives on TIGTA's identification of the most challenging management concerns facing the IRS?

Response: Each year, TIGTA identifies the IRS's major management and performance challenges based on the findings and results of prior audit work and other analyses. TIGTA then designs and delivers an audit plan with audit work focused in each of the top 10 areas. In FY 2017, TIGTA reported IRS top management and performance challenges, in order of priority, as:

1. Security Over Taxpayer Data and Protection of IRS Resources
2. Identity Theft and Impersonation Fraud
3. Implementing the Affordable Care Act and Other Tax Law Changes
4. Improving Tax Compliance
5. Reducing Fraudulent Claims and Improper Payments
6. Improving Tax Systems and Expanding Online Services
7. Providing Quality Taxpayer Service Operations
8. Impact of Global Economy on Tax Administration
9. Protecting Taxpayer Rights
10. Achieving Program Efficiencies and Cost Savings

TIGTA included identity theft as a new challenge in FY 2017, removing human capital from the list. We certainly agree these areas represent important challenges and opportunities for the IRS.

TIGTA's FY 2017 Annual Audit Plan contained 168 new or in-process audits focused on these 10 challenges. Leadership and management enterprise-wide are actively engaged throughout the audit process and appreciate our auditors' objective reviews of IRS programs and processes. We carefully consider all reported findings and recommendations.

I personally appreciate TIGTA's insightful and continued attention to the most challenging concerns the IRS faces, and consider TIGTA a partner in helping the IRS achieve its mission.

- How does the IRS under your leadership integrate the findings and recommendations for corrective action suggested by GAO and TIGTA audits into strategic management decision-making and budget planning processes?

Response: As mentioned above, we carefully consider all reported findings and recommendations by TIGTA and the Government Accountability Office (GAO). We must ensure we use our budget and resources to address the most significant

vulnerabilities identified. Since 2015, the GAO has provided a list of its Priority Recommendations, asking us to focus on the recommendations it cited as having the highest priority.

Responsible officials at the management and executive level must assess whether taking corrective action in the finding area is mission-critical and if funding is available. If funding is not available when management is responding to the reported findings, a business unit may place a recommendation on hold and leadership may periodically assess its status throughout the budget cycle. As of August 15, we have 219 outstanding corrective actions in our inventory, with another 18 on hold. More than 100 new corrective actions will be added to our inventory as FY 2017 audit activity concludes.

7. IRS Reporting Requirements

In November 2016, the IRS issued Internal Revenue Notice 2016-66. There have been numerous complaints that this notice imposes burdensome and duplicative information reporting requirements on 831(b) Captives, their owners and, in some cases, even their service providers.

- Will the IRS commit to carefully reexamine the requirements imposed by this Notice, including meeting with small and medium-sized businesses that are impacted by new reporting requirements to understand their concerns?

Response: We issued Notice 2016-66 late last year to identify certain micro-captive transactions as transactions of interest because they have the potential for tax avoidance or evasion. As you note, the notice requires disclosure from participants in the identified transactions and their material advisors. These disclosures allow the IRS to gather information to determine which transactions are or have the potential to be abusive tax avoidance transactions. We have begun to evaluate the information we have received in these disclosures to determine what steps are appropriate as we work toward addressing potential tax abuse in this area.

To minimize the burden of the disclosure requirements, we carefully crafted the objective criteria in Section 2 of Notice 2016-66, which describes the micro-captive transactions that are subject to disclosure. Specifically, we require disclosure only if an insured entity or a related party owns at least 20 percent of an electing section 831(b) captive insurance company, and for the most recent five-year period the captive insurance company either has liabilities less than 70% of its premiums earned or has made its capital available to the insured entity or a related party.

We requested comments from the public about the notice and received 28 comments and six congressional inquiries, including this Question for the Record. In addition, we met with those who requested meetings and responded to telephone calls regarding the notice. Subsequently, the United States Tax Court issued its first decision on a micro-captive transaction challenged by the IRS (*Avrahami v.*

Commissioner, 149 T.C. No. 7, filed August 21, 2017), concluding that the entity purported by the taxpayers to be a micro-captive insurance company was not an insurance company and holding that payments made to that entity did not qualify as insurance premiums. We will continue to evaluate the disclosures received and developments in this area.

SUBMITTED BY SENATOR MANCHIN

1. Modification of Tax Documents

Commissioner Koskinen:

IRS taxpayer notices are the primary mode by which the IRS communicates with taxpayers. As you often say, in an effort to prevent phone scams involving people impersonating IRS officials “If you are surprised to be hearing from us, you aren’t hearing from us.”

However, the way that IRS communicates with taxpayers by mail is frustrating to many. 10% of IRS notices don’t reach their intended audience, which represents a total failure of communications at roughly twice the industry average. When a taxpayer receives a notice, it is often an indecipherable block of text using stock language and no visual or graphical clues as to what the taxpayer should do or why.

Moreover, IRS plans to address its high failure rate, which involve moving to online communications, are destined to be incomplete solutions at best.

My recommendation would be for IRS to learn from the best practices at use in industry. When I get a statement for a credit card or utility, it uses color, modern iconography, and clear text because that credit card or utility knows that it is in their interest and my interest for me to be able to understand the information that is being conveyed.

QUESTION

- **When will IRS implement color and graphics in order to make its notices more understandable?**

Response: I agree that we need to ensure that our communications with taxpayers are as clear as possible. We began to revise notices in 2010 to comply with the Plain Writing Act of 2010. Since 2010, we have reviewed all new and revised notices for compliance with the Plain Writing Act on a continuing basis. Our goal is to create notices that are clear, concise, and well-organized and that follow best practices. We do not have the color printers necessary to produce color notices. We need to conduct more in-depth analysis of the requirements necessary to determine a full implementation schedule and cost.

- **What is IRS doing to reduce its undeliverable mail problem?**

Response: Over the past several years, we have implemented several mailing best practices to reduce undeliverable mail. To obtain the most current valid address, we run a series of address update routines. Following industry best practices, we use commercial address hygiene software approved by the United States Postal Service (USPS) that validates each address. We also consult the USPS National Change of Address (NCOA) dataset so our records are updated to reflect the most current address available. In 2013, we began using USPS Full Service Intelligent Mail barcodes that provide the ability for enhanced tracking and improved address quality. We are also exploring several other address initiatives, including providing a secure method for taxpayers to change their addresses online.

We have improved since 2010 when TIGTA issued its report about undeliverable mail. The report stated that IRS FY 2009 undeliverable mail volume was 19.5M (201M mailed). The FY 2016 undelivered mail volume was 16.3M (215M mailed). The current FY 2017 IRS deliverability of mail rate is 92.6 percent. This rate is lower than the industry average. Most undeliverable mail is caused by a taxpayer moving and not providing a forwarding address or providing a bad, uncorrectable address.

2. Tax-Payer Assistance

Commission Koskinen:

As you mention in your testimony, there's no question that the efficient operation of the Internal Revenue Service is integral to the functioning of our government. Plain and simple, our government needs revenue to work.

For many citizens, especially those in rural areas like West Virginia, the Internal Revenue Service has, in fact, become less of a service. As the IRS continues to find ways to cut costs, access to paper forms and assistance has continually been reduced. Furthermore, the switch to offering online services may be favorable for some – but only for people who have broadband access and feel comfortable using the internet. Unfortunately, this is not the case for many West Virginians.

Many West Virginians simply want to pay what taxes they owe and comply to the best of their ability. It just makes sense that the IRS would want to help people comply before they need to file so that we don't waste resources on the back end through enforcement measures and cause our citizens unnecessary headaches.

QUESTION:

In the budget justification, a cut of \$153 million is proposed to the office of Taxpayer Services. How does this funding reduction contribute to improving the service aspect of the Internal Revenue Service?

Response: We provide service through a variety of channels, including toll-free service, walk-in assistance, correspondence, and a growing range of online self-assistance tools funded by the Operations Support account, not from the Taxpayer Services account. We support the Administration's efforts to reform the federal government and deliver services in the most efficient manner possible. Funds are provided to help us update our out-of-date IT infrastructure. We are committed to providing services that will satisfy taxpayer needs by taking advantage of the latest tools and technology aimed at transforming the entire taxpayer experience. We continue to develop ways to provide our services so taxpayers can conveniently and securely engage us at the time and place of their choosing.

To do that, we need to continue to invest in new information technology and services. Reducing funding in Taxpayer Services may affect level of service on the phones and in-person interaction, depending on the volume of interactions. However, investing in our online capabilities will improve our ability to provide our services as more and more taxpayers choose to interact with us online in a secure, virtual environment in the same manner they do with other financial institutions. The more often taxpayers successfully obtain the information and help they need by visiting IRS.gov and using our online tools, instead of calling or visiting, allows for greater capacity to help those taxpayers who prefer or need to interact with us on the phone or in person.

U.S. Senate Committee on Appropriations
Senate Financial Services and General Government Appropriations Subcommittee
“Hearing to review the Fiscal Year 2020 funding request and budget justification for the
U.S. Department of the Treasury”
May 15, 2019

Questions for Commissioner Charles P. Rettig

Questions for the Record from Vice Chairman Patrick Leahy

1. Secretary Mnuchin has refused to provide President Trump’s personal and business tax returns to the Congress, arguing that it would be “unlawful,” “lacks a legitimate purpose,” and is a violation of privacy. This is contrary to the plain, unambiguous language of the tax code. Given the Secretary’s claims, I believe it important to understand how the IRS and Treasury Department have handled previous Congressional requests for tax returns.

- a. Please provide a list of every tax return provided to Congress following a formal request. Please also provide a list of every tax return the IRS has refused to provide to Congress following a request.

The IRS is precluded by law from disclosing tax returns or tax return information. *See Internal Revenue Code Sections 6103 and 7213.* That prohibition is broad and precludes IRS employees from confirming the existence or non-existence of returns and return information. Although there are exceptions to that prohibition, none of those exceptions would allow me to provide you with a list of tax returns that the IRS has, or has not, provided to Congress. I can refer you, however, to the Treasury Department’s June 27, 2019 and July 17, 2019 letters to Senator Wyden, which contain certain information that is relevant to your request.

2. *The Washington Post* reported on May 21, 2019, that it had seen a 10-page IRS memoranda concluding that it was “mandatory” that the Treasury secretary release tax returns requested by chairs of the tax-writing committees.

- a. Did anyone share this memoranda prior to May 21, 2019, with any Treasury Department leadership, including but not limited to Secretary Mnuchin, or with anyone in the White House?

To the best of my knowledge, no written materials prepared by any IRS employee concluding that it is mandatory to release a president’s return or return information in response to a Congressional request were shared with any Treasury Department leadership, including but not limited to Secretary Mnuchin, or with anyone in the White House.

- b. Did anyone at the IRS inform Treasury Department leadership, including but not limited to Secretary Mnuchin, of its belief that it must share tax returns requested by the chairs of the tax-writing committees?

This question appears to assume that the IRS concluded that the Department was required to share the tax returns and return information requested by Chairman Neal on April 3, 2019. That is not correct. To understand the legal advice on which the IRS relied in

connection with this matter, I would refer you to the opinion of the Office of Legal Counsel.

3. In an opinion filed on May 20, 2019, in *Donald Trump v. Committee on Oversight and Reform of the U.S. House of Representatives*, U.S. District Court Judge Amit Mehta detailed the broad deference afforded to Congress under the law when evaluating the legislative purpose behind congressional subpoenas.
 - a. Has the IRS re-evaluated its obligation to comply with President Trump's tax returns in light of Judge Mehta's May 20 opinion?

I would refer you to footnote 19 of the opinion of the Office of Legal Counsel, which addresses Judge Mehta's May 20 opinion.

4. I have been concerned for some time about the long-term impact that budget cuts have had on the IRS, its ability to achieve its mission, and the morale and workload of its employees. According to reporting by Pro Publica and the Atlantic, the number of audits conducted in 2017 was 42 percent lower than the number conducted in 2010. This same reporting found that investigation of non-filers fell to 362,000 in 2017, compared to 2.4 million in 2011. The result is \$3 billion in lost revenue each year. These enforcement statistics are incredibly concerning, but the IRS also faces challenges protecting taxpayer data, improving its IT system, and providing taxpayers with sufficient help during filing season. On top of that, the 35 day government shutdown forced many IRS employees to either be furloughed or work without pay. Despite these challenges, the President's FY 2020 budget requests only \$11.5 million for the IRS, which represents a more than 5 percent cut from FY 2010 levels.

- a. How can the IRS meet all these growing and persistent challenges if the Administration's budget request continues to fall below what the Agency's needs were a decade ago?

The FY 2020 President's Budget base request for the IRS includes \$11.5 billion (2.2 percent increase over the FY 2019 Enacted level excluding the funds provided for Tax Cuts and Jobs Act implementation). The request will allow the IRS to:

- Help all taxpayers meet their tax obligations by simplifying the process of filing and amending returns and submitting payments;
- Protect the integrity of the tax system by reviewing and enforcing the tax code; Partner with key stakeholders in the state and local tax administration, tax preparation, and international communities;
- Cultivate and retain a well-equipped, diverse, flexible, and engaged workforce;
- Advance data access, usability, and analytics to inform decision making; and
- Drive increased agility, efficiency, effectiveness, and security in operations.

The Budget includes \$290M for the IRS modernization initiative which will deliver the services taxpayers expect from any financial organization, improve systems supporting our taxpayer services and enforcement personnel, and enhance the IRS's ability to detect and stop cyberattacks and protect taxpayer data.

The Budget includes an increase of: \$101 million to support the ongoing operations and maintenance of IRS's IT systems; \$22 million to increase the IRS efforts to protect taxpayers from identity theft and pursue those who steal taxpayers' identities to file for a refund before the legitimate taxpayer files his or her return; \$34 million to expand data

analytics across the IRS and improve IRS's risk identification capabilities, reducing the need for staff to conduct manual or limited risk assessments. Funding these priorities will help the IRS achieve its mission of providing America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

In addition to the base request, the Budget proposes a \$362 million discretionary program integrity cap adjustment in FY 2020 to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS's overall tax enforcement program. Moreover, the President's Budget includes legislative proposals that, if enacted by Congress, will improve tax administration such as a greater flexibility to address correctable errors and improving oversight of paid tax preparers.

5. I continue to be concerned about the lack of resources being provided to assist rural taxpayers, particularly during filing season. The IRS has been closing Taxpayer Assistance Centers (TACs) and attempting to replace these in-person services with online resources. While this may make sense in urban centers that have ready access to broadband, rural areas, including many in Vermont, lack this option.
 - a. Will the IRS consider broadband availability when making decisions on how to provide taxpayers in rural areas with the same assistance resources that are available to those in urban areas?

We recognize that our obligation to serve all taxpayers requires the IRS to provide multiple ways to get assistance. The IRS is committed to finding ways to ensure all taxpayers have convenient and efficient service options including face-to-face, telephone service, virtual service delivery and online options. For example, if a taxpayer requires a paper copy of any current-year forms, instructions and publications (except Publication 17), as an alternative to ordering them from www.irs.gov/orderforms, a taxpayer can call 1-800-829-FORM (3676). Generally, taxpayers receive products within 10 business days if they are available. For transcripts, taxpayers without internet access can call the automated transcript toll-free line (1-800-908-9946), or mail or fax Form 4506-T, *Request for Transcript of Tax Return*. Transcript requests are generally processed within 10 business days and then mailed to the taxpayer's address of record.

The IRS makes decisions about location and staffing of Taxpayer Assistance Centers (TACs) after evaluating the population covered, distance between the TACs, services most frequently requested in the area, cost, and availability of alternative services, including services through our trusted partners. Toll-free phone lines continue to be the number one choice for getting assistance with account and tax law questions. The IRS answered nearly 17 million calls this fiscal year through June.

To continue providing face-to-face services outside of the traditional TAC model, the IRS has been exploring various options. For example, as of June 2019, we have 35 partner cities that host the IRS Virtual Service Delivery technology. This technology enables taxpayers to receive assistance from TAC employees in another geographic area of the country via an IRS computer and high-resolution video. Thus, the IRS is able to maintain virtual face-to-face services without placing any technology demands on taxpayers. Additionally, the IRS partnered with the Social Security Administration (SSA) to pilot a program that co-locates IRS TAC employees within

SSA office space. These collaborations provide additional service channels in geographic locations without a TAC.

The IRS also continues to look for innovative ways of providing taxpayer services for taxpayers without broadband, particularly by enhancing options for taxpayers who use mobile devices. For example, the IRS redesigned IRS.gov, making it mobile friendly. This means the site will resize and adapt based on the screen size or the type of device used, including a smartphone or tablet. Another example is the IRS2Go App, which is the official IRS smartphone application compatible with Apple and Android mobile devices. Taxpayers don't need a computer or broadband to check their refund status, make a payment, find free tax preparation assistance, sign up for helpful tax tips, and more. IRS2Go is available in both English and Spanish. In addition, we offer 100 commonly used Instructions and Publications in eBook format. IRS eBooks for mobile devices are free and are provided in the ePub format.

6. According to the IRS 2018 Data Book released recently, the IRS only audited 0.59 percent of individual income tax returns last year – the lowest rate since 2002. According to several reports, audit rates of the highest income earners dropped the most dramatically. According to the Government Accountability Office, the gap between taxes owed and taxes paid is in excess of \$400 billion. Separate studies show lower income Americans are the most likely to be audited. Audit rates in the Northeast Kingdom, the most economically challenged and lowest income areas of Vermont, are higher than the rest of the state.

- a. Will the IRS request additional funding and increase staffing levels to close the tax gap?

The FY 2020 Budget includes funding, staffing, and legislative proposals to help reduce the tax gap, including the program integrity cap adjustment proposal, the tax administration proposals, and the data analytics initiative

- b. Does the IRS plan to develop and document a strategy that outlines how IRS will use data to update compliance strategies, as recommended by the Government Accountability Office?

In its report *Tax Gap: IRS Needs Specific Goals and Strategies for Improving Compliance* (GAO-18-39), GAO's second recommendation focused on the use of National Research Program (NRP) data for updating compliance strategies. Specifically, GAO recommended that "[t]he Commissioner of Internal Revenue should instruct the appropriate officials to develop and document a strategy that outlines how IRS will use National Research Program data to update compliance strategies that could help address the tax gap."

In response to GAO's recommendation, the IRS committed to preparing a document to outline both a plan for conducting NRP studies to collect the requisite data and a process that would better integrate the analysis of NRP data with decision-making about compliance strategies.

- c. What does the IRS plan to do to ensure individual income tax return audits are equitable and that the IRS is getting the greatest return on investment in audits?

It is important to maintaining the voluntary compliance level that the IRS has an audit presence across all income groups. In FY 2019 the IRS has undertaken significant hiring

to ensure that it can enforce and administer tax law equitably. The IRS plans to open additional audits in FY 2019 in the high-income high wealth category.

7. Vermont has 25 census tracts designated as Opportunity Zones by the Department of the Treasury and the Internal Revenue Service as of April 2018.

- a. How much money has been invested in Opportunity Zones in Vermont to date?

For Tax Year (TY) 2018, the IRS did not capture the information requested.

On April 17, 2019, the Treasury Department issued its second set of proposed regulations under Section 1400Z-2 (Investing in Qualified Opportunity Funds, 84 FR 18652). The proposed regulations state that IRS Form 8996, *Qualified Opportunity Fund*, is expected to be revised for TY 2019 and following years to require, among other things, the amount invested by qualified opportunity funds and qualified opportunity zone businesses located in qualified opportunity zones.

While the data is expected to be available from TY 2019 filings, reporting the data is not part of tax administration. Any inquiries for such data should be directed to the Department of Treasury.

- b. How much in each zone?

For TY 2018, the IRS did not capture the information requested. See response above.

Questions for the Record from Senator Joe Manchin

1. Tax Reform

- When we first started talking about tax reform, I believed that real reform needed meet a few goals: it needed to focus on permanent relief for working class families; make small businesses and corporations competitive in a global economy; be fiscally responsible; and simplify the tax code.
- I know that the tax bill did not meet those goals because anything that is done in such a strictly-partisan way cannot be good for West Virginia or the country as a whole.
- Let me be clear, I've always supported tax cuts to grow our economy and raise wages, but the tax bill unquestionably adds to our already staggering national debt.
- Our growing national debt significantly harms our military readiness, the ability to equip our National Guard to answer the call for domestic emergencies, and care for our veterans.

Questions

- a. What are the Administration's plans to deal with the \$22 Trillion national debt?

The President has been very focused on rebuilding the military and military spending, which is very important. In order to achieve that, the Democrats in Congress required an enormous increase in non-military spending, which we cannot afford over the longer term. The Administration will be looking at addressing the debt and deficits. The good news is that the economic growth resulting from tax cuts, deregulation, and improved trade deals will create additional revenue to help reduce the debt over time.

- b. Can you tell me the ways in which working Americans have directly benefited from tax reform?

American taxpayers saw lower rates, more jobs and higher wages as a result of the Tax Cuts and Jobs Act. At the IRS we are committed to ensuring that the success of the Tax Cuts and Jobs Act is sustained.

- c. How much of an impact did the shutdown have on IRS's ability to provide services to American taxpayers?

The lapse in appropriations presented an opportunity for us to demonstrate to the American people our strength of dedication to our mission. I am proud of our employees. They care deeply about their duties and responsibilities and have consistently delivered for the nation every tax season and through national disasters and emergencies. The partial shutdown created challenges for our employees, who generally were unpaid during this period. Despite the lapse, the IRS implemented the largest tax law change in over 30 years, started the filing season on time and as planned, and issued nine out of ten refunds within 21 days. Almost 96 million refunds were issued this filing season, totaling over \$260 billion paid to taxpayers.

Self-help tools on IRS's website were available during the shutdown but the lapse in appropriations did impact some of the services the IRS provides to taxpayers. For example, taxpayer meetings and responses to correspondence and phone calls were delayed. This means that some taxpayers with outstanding tax balances, lien requests, seized property, and other issues faced delays in having their cases addressed. Self-help tools on IRS's website were available during the shutdown. In addition, examinations that were open at the time of the shutdown required an additional 45 days to complete.

Other processing programs that experienced a backlog due to the shutdown include Certified Professional Employer Organization application and renewals; Form 637, Application for Registration for Certain Excise Activities; and Form 8300, Report of Cash Transactions over \$10,000 Received in a Trade or Business processing into the FinCEN system.

2. Qualified Improvement Property Tax Fix

- Because the Tax Cuts and Jobs Act (TCJA) was rushed through on a party-line vote, there were mistakes.
- One of which has actually made it harder for retailers and restaurant owners to invest in their businesses and create jobs.
- The depreciation period for qualified improvement property (QIP) was significantly lengthened under the current law – from 15 to 39 years and is not available for immediate expensing.
- In September of last year, before you were confirmed, I signed a letter to Secretary Mnuchin highlighting the error in the new tax law.
- I'm also an original co-sponsor of bipartisan legislation with Senators Toomey and Jones which corrects this error and restores the law to reflect the original congressional intent.

Questions

- a. Do you agree this was a technical error and that the original intent of the Tax Cuts and Jobs Act was for qualified improvement property to have a 15-year depreciation life and allow for 100% of immediate expensing?
 - i. If so, why can't you fix it?

[See below response.](#)

- ii. Why do you need new legislative authorities to fix a drafting error?

[We are aware of the concern that the TCJA unintentionally changed the recovery period for QIP to 39 years, thus making QIP ineligible for bonus depreciation under Section 168\(k\). After carefully studying the issue, however, we have determined that we do not have regulatory authority to change this result through guidance. We would fully support a technical correction to address the issue.](#)

- b. Are there other important clerical errors that you believe the IRS can not correct and require the action of Congress?

[Typically, when tax legislation is passed, there is a process for addressing technical corrections that is organized by the Joint Committee on Taxation, Senate Committee on Finance, and the House Committee on Ways & Means. They identify particular corrections that conform to the original intent of the legislation.](#)

- c. Do you think that tax reform should be bipartisan?

[Tax reform proposals and legislation should be evaluated on the benefit they provide to the American taxpayer. If a bipartisan plan for tax reform does that better than another plan, then yes.](#)

3. Modernizing the IRS

- I know you are committed to putting the agency's information technology (IT) infrastructure on a path toward modernization. In April, the IRS released its Integrated Modernization Business Plan that provides a six-year roadmap for modernizing IRS systems and taxpayer services.
- There's no question that the efficient operation of the Internal Revenue Service is integral to the functioning of our government. However, I want to point out that the dynamics in rural areas like West Virginia need to be kept in mind as the modernization plan is rolled out.
- If the IRS begins to limit constituent access to paper forms to make their processing more efficient and switches to online services it may only be favorable to some. For the people who don't have broadband access or don't feel comfortable using the internet this will result in a disservice. And unfortunately, this is the case for many West Virginians.

Questions

1. In the IRS's modernization plan and the shift to online services will there continue to be traditional paper methods available, so rural areas like West Virginia are not hurt by these changes?

[See response below.](#)

2. Will you commit to advocating for rural areas in this roll out?

We recognize that our obligation to serve all taxpayers, including those in rural areas, requires the IRS to provide multiple ways to get assistance. The IRS is committed to finding ways to ensure all taxpayers have convenient and efficient service options including face-to-face, telephone service, virtual service delivery and online options.

Questions for the Record from Senator Chris Van Hollen

1. At the hearing, I asked Secretary Mnuchin about the decision not to provide the tax returns and return information requested by Ways and Means Committee Chairman Neal. The Secretary testified that he had had multiple conversations with you, Treasury's legal counsel, and the IRS's legal counsel, jointly, and that you had "independently concurred" with his decision in reliance on legal advice provided to you by the IRS Chief Counsel.

On April 9, 2019, the day before Chairman Neal's deadline, you testified before the Subcommittee on Financial Services and General Government of the House Committee on Appropriations. At that hearing, you had the following exchange with Chairman Quigley:

Chairman Quigley: What have your legal experts told you? It's hard to imagine, sir, that they are going to say at five minutes until midnight "okay, what are we going to do?" I would assume that you all have started to have these discussions. They would have given you some amount of legal understanding as to what your choices were and what the law says. Did they talk to you at all or did you ask about whether you have discretion whether to respond or to comply?

Commissioner Rettig: I have not asked, and I think it would be premature for me to speculate with you now.

Chairman Quigley: Would it have been premature to ask them if you have discretion?

Commissioner Rettig: I have not asked.

In light of your statements to Chairman Quigley and Secretary Mnuchin's statements, please provide answers to the following questions:

- a. Was Secretary Mnuchin's testimony incorrect?

No. In reliance on the advice of the Justice Department's Office of Legal Counsel, I concurred with the Secretary's May 6 letter to Chairman Neal.

Regarding my colloquy with Chairman Quigley, my testimony was in response to a specific question from the Chairman regarding discretion to act on Chairman Neal's request, not about all communications with the Office of Chief Counsel regarding that request. I did have several oral conversations with the Office of Chief Counsel prior to April 9, 2019 regarding Section 6103(f).

- b. Why, as Commissioner, did you never ask for legal advice? Was it because you knew what the legal advice would say?

I did receive legal advice, as explained above.

- c. When did your meetings with Secretary Mnuchin, Treasury counsel, and IRS counsel take place?

I meet with Secretary Mnuchin on an approximately biweekly basis. To the best of my recollection, we discussed the matter of Chairman Neal's request after it was received in April and again in May.

- d. You stated in a May 6, 2019 letter that you "concur with the letter sent to [Chairman Neal] today by Secretary Mnuchin and the conclusion reached in that letter." Were you doing so in reliance on legal advice provided to you by the IRS Chief Counsel or any other attorney in the Office of Chief Counsel on Congressional access to returns and return information?

I relied on legal advice provided by both the IRS Chief Counsel and the Department of Justice.

- e. If so, when did the IRS Chief Counsel, or any other attorney in the Office of Chief Counsel, provide you with legal advice?

I had several oral communications with the Chief Counsel and the Counselor to the Commissioner on this topic, beginning on April 3, 2019, when Chairman Neal issued his request.

- f. Did the Office of Chief Counsel provide any legal advice as to whether section 6103 of the Tax Code provides for discretion?

No.

1. Did the Office of Chief Counsel provide you, or any of your close advisors or IRS senior staff, with written guidance, in draft form or otherwise, that examined how Section 6103(f) applies to requests by the tax-writing committees?

When I testified on April 9, 2019, I was not aware of any written analysis, in draft form or otherwise, that examined how Section 6103(f) applies to requests by the tax-writing committees.

2. Please answer the following questions regarding the draft IRS memorandum entitled "Congressional Access to Returns and Return Information."

The IRS did not authorize the release of any such draft memorandum (whether entitled "Congressional Access to Returns and Return Information" or otherwise) and any release of such memorandum may violate the law. I therefore respectfully decline to answer your specific questions about any such draft memorandum at this time. I have provided more general information, however, which I hope you will find helpful.

- a. Did you ever ask not to be told what was in the memorandum?

I have never asked not to be told about the application of Section 6103(f).

- b. When was this memorandum drafted? Please provide the date on which the file was created and the date on which the file was last modified.

Because release of any such draft memorandum (whether entitled "Congressional Access to Returns and Return Information" or otherwise) has not been authorized and may violate the law, I respectfully decline to answer this specific question at this time.

- c. Was this memorandum ever finalized? If not, who made the decision that it not be finalized?

Please see response above.

- d. Did the current Chief Counsel, or any former Chief Counsel, ever review a draft of this memorandum or know about the existence of the draft memorandum?

Until the issue came to their attention in connection with press reports, neither Chief Counsel Michael Desmond nor his predecessor Acting Chief Counsel William Paul were aware of any such draft memorandum (whether entitled “Congressional Access to Returns and Return Information” or otherwise).

- e. Does the IRS ever provide legal memoranda to Treasury?

Yes, the IRS Office of Chief Counsel does, on occasion, provide legal memoranda to Treasury.

- f. Did you ever receive analysis with conclusions similar to those found in this memorandum from anyone in the IRS Office of Chief Counsel, any of your close advisors, or any IRS senior staff?

As I have explained, I had several oral conversations with the Office of Chief Counsel and my senior advisors regarding Section 6103(f). However, it would not be appropriate for me to disclose the content of those conversations.

- g. At any time, have you and Secretary Mnuchin discussed this memorandum? If so, please summarize your discussions with Secretary Mnuchin?

I was not aware of any written materials prepared by any IRS employee regarding Section 6103(f) until we received press inquiries shortly before and relating to the article that appeared in the Washington Post on May 21, 2019.

- h. At any time, have you discussed this memorandum with anyone in the White House? If so, please summarize those discussions?

I have not had any discussions with anyone in the White House about Section 6103(f) or any written analysis thereof.

3. Internal Revenue Manual 4.2.1.11 provides that the “*individual* income tax returns for the President and Vice President are subject to mandatory examinations” (emphasis added). At the hearing, I asked you whether this mandatory examination would include a review of all (i) ongoing audits for tax years that predate the individual’s term as President or Vice President and (ii) business enterprises in which the individual has an ownership interest.

In your testimony, you provided general statements as to the IRS’s audit procedures and stated that the “the President or Vice President would be audited, and the process of auditing any taxpayer, including the president and vice president, should pick up the entities that that person is related to.” However, as we know, the President is not just any taxpayer, which is why the mandatory presidential audit was instituted in the first place. Therefore, please clarify the following:

- a. Does the IRS automatically audit the returns for all entities in which the President has an ownership interest? If so, which provision of the Internal Revenue Manual provides for that? If not, how does the IRS determine which entities to include in its audit, and is any aspect of that determination left to the discretion of IRS staff?

The scope and depth of a mandatory examination is determined by reference to established risk protocols. Examiners must use their professional judgment to set the scope of the examination. Based on risk protocols, the scope of the mandatory examination can be expanded to include prior years and related returns as well as other types of tax liabilities (*e.g.*, gift tax liabilities and employment tax liabilities with respect to household employees). IRM 4.2.1.15(6).

- b. Does the IRS automatically continue audits of the President's returns that were ongoing when the individual became President? If so, which provision of the Internal Revenue Manual provides for that? If not, how does the IRS determine which ongoing audits to continue, and is any aspect of that determination left to the discretion of IRS staff?

Once an examination of any taxpayer is started, it is completed in accordance with IRS procedures, regardless of whether the taxpayer is an officeholder. Policy Statement P-4-7 provides that it is the examiner's duty to determine the correct amount of the tax with strict impartiality between the taxpayer and the Government, and without favoritism or discrimination as between taxpayers.

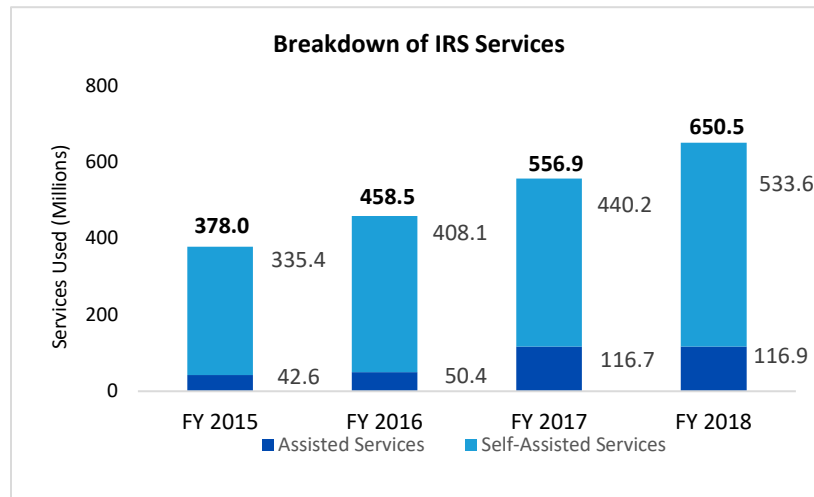
4. Commissioner Rettig, the telephone level of service at the IRS has improved significantly in recent years, after significant deterioration due to lack of funding. During the 2015 filing season, the IRS only answered 37% of taxpayer calls, leading Congress to provide the IRS with additional funding in recent years that improved the telephone level of service to 76% in FY 2018. I am concerned that the Administration's FY 2020 request calls for reducing funding for taxpayer services by almost \$90 million, which the Administration acknowledges would lower the phone level of service to 68% in FY 2020.

- a. Is there a policy reason for making it harder for taxpayers to communicate with the IRS?

We recognize that our obligation to serve all taxpayers, requires the IRS to provide multiple ways to get assistance. The IRS is committed to finding ways to ensure all taxpayers have convenient and efficient service options including face-to-face, telephone service, virtual service delivery and online options. In response to shifting taxpayer preferences, the IRS has increased services that make it easier for taxpayers to interact with the IRS via online digital tools. These tools are in addition to the face-to-face assistance provided by our Taxpayer Assistance Centers and through telephone service.

Self-assistance services increased by more than 59 percent from FY 2015 to 2018. For example, use of the *Where's My Refund?* application rose by 32 percent from 234 million in FY 2015 to 309 million in FY 2018. The IRS has also increased the services it provides through the taxpayer online accounts.

Expanding secure digital options to empower and enable taxpayers, while maintaining and improving traditional services, remains a key IRS objective.



- b. Did the IRS recommend this reduction to bring the overall IRS budget within the constraints of the President's FY 2020 budget?

The FY 2020 President's Budget base request for the IRS includes \$11.5 billion (2.2 percent increase over the FY 2019 Enacted level (excluding the funds provided for Tax Cuts and Jobs Act implementation). The request will allow the IRS to:

- Help all taxpayers meet their tax obligations by simplifying the process of filing and amending returns and submitting payments;
- Protect the integrity of the tax system by reviewing and enforcing the tax code; Partner with key stakeholders in the state and local tax administration, tax preparation, and international communities;
- Cultivate and retain a well-equipped, diverse, flexible, and engaged workforce;
- Advance data access, usability, and analytics to inform decision making; and
- Drive increased agility, efficiency, effectiveness, and security in operations.

The Budget includes \$290M for the IRS modernization initiative which will deliver the services taxpayers expect from any financial organization, improve systems supporting our taxpayer services and enforcement personnel, and enhance the IRS's ability to detect and stop cyberattacks and protect taxpayer data.

The Budget includes an increase of: \$101 million to support the ongoing operations and maintenance of IRS's IT systems; \$22 million to increase the IRS efforts to protect taxpayers from identity theft and pursue those who steal taxpayers' identities to file for a refund before the legitimate taxpayer files his or her return; \$34 million to expand data analytics across the IRS and improve IRS's risk identification capabilities, reducing the need for staff to conduct manual or limited risk assessments. Funding these priorities will help the IRS achieve its mission of providing America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

In addition to the base request, the Budget proposes a \$362 million discretionary program integrity cap adjustment in FY 2020 to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS's overall tax

enforcement program. Moreover, the President's Budget includes legislative proposals that, if enacted by Congress, will improve tax administration such as a greater flexibility to address correctable errors and improving oversight of paid tax preparers.

5. Commissioner Rettig, the Administration's FY 2020 request proposed reducing base funding for enforcement by roughly \$155 million, and then proposes additional funding through an adjustment to the overall nondefense discretionary spending cap. Some estimates indicate that every \$1 spent on enforcement efforts generates roughly \$6 in increased revenues. This comes from reducing the tax gap – meaning the difference between total taxes owed and taxes paid – which the IRS estimates to be roughly \$406 billion.

- a. Would cutting IRS enforcement funding lead to an increase in budget deficits, because reduced revenue collections exceed the savings from the spending cut?

A strong, robust, visible enforcement presence by the Internal Revenue Service supports the voluntary compliance system. Taxpayers need to know that those who do not comply with the tax law run a substantial risk of being caught. The 2020 Budget includes \$4.7 billion for enforcement efforts, including the examination of tax returns, both domestic and international; enforcement of statutes relating to detection and investigation of criminal violations of the internal revenue laws; identification of underreporting of tax obligations; securing of unfiled tax returns; and collection of unpaid accounts. In addition, it also proposes a \$362 million discretionary program integrity cap adjustment in FY 2020 to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS's overall tax enforcement program.

In addition, the IRS is working on its IT systems, with respect to data and analytics, to be able to better apply resources to maximize the return on investment and assist with efforts to take enforcement actions where appropriate. Better systems will allow better case selection, so the IRS avoids using resources on activities that have little deterrent effect. This approach will ultimately result in greater revenue collection. For example, the 2020 Budget includes \$34 million to expand data analytics across the IRS and improve IRS's risk identification capabilities, reducing the need for staff to conduct manual or limited risk assessments

Financial Services and General Government Subcommittee

Hearing Charles P. Rettig, Commissioner, Internal Revenue Service

Questions for the Record Submitted by Congresswoman Torres

SALT Deduction:

The Tax Cuts and Jobs Act (TCJA) is going to take a disproportionate toll on California taxpayers. In our state, taxpayers pay significant state and local taxes (SALT) to fund critical services for those in need. The average Californian pays \$18,438 in state and local taxes, but under the new tax bill, the SALT deduction is capped at \$10,000. In 2015, constituents in my district deducted over \$682 million dollars in state and local taxes.

Question: Are you already seeing the impact of this cap on Californians tax filings?

Given that there are a significant number of individuals who request and receive extensions to file their return on or before October 15, it is not possible to evaluate tax year 2018 until more complete data become available.

Question: Does the IRS have any predictions as to how this cap will impact Californians?

The IRS produces projections of the number of tax returns to be filed, for workload planning purposes, but does not produce projections of the impact of tax provisions on specific taxpayer groups.