NTEU
The National Treasury Employees Union

Testimony

of

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before the

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Chairman Jones, Members of the Board, and other distinguished guests, my name is Colleen Kelley and I am the National President of the National Treasury Employees Union (NTEU). As you know, NTEU represents some 150,000 federal employees in 30 federal agencies and departments, including the men and women who work at the Internal Revenue Service. I appreciate you giving me the opportunity today to present recommendations regarding efforts to close the tax gap.

In April 2006, the IRS released updated estimates showing that the tax gap was approximately $345 billion in Tax Year 2001. As Nina Olson, the National Taxpayer Advocate noted, this amounts to a per-taxpayer "surtax" of some $2,000 per year to subsidize noncompliance. And while the agency has made small inroads and the overall compliance rate through the voluntary compliance system remains high, much more can and should be done. NTEU believes that in order to close the tax gap, the IRS needs additional employees on the frontlines of tax compliance and customer service. In addition, we believe Congress should establish a dedicated funding stream to provide adequate resources for those employees.

History has shown that the IRS has the expertise to improve taxpayer compliance but lacks the necessary personnel and resources. The President's own fiscal 2008 budget proposal trumpets the increased tax collections produced by IRS's own employees and cites the increased collections of delinquent tax debt from $34 billion in 2002 to $49 billion in 2006, an increase of 44 percent. Unfortunately, instead of providing additional resources to hire more enforcement staff, IRS personnel resources have been slashed in recent years resulting in a 36% decline in combined collection and examination function enforcement staff between 1996 and 2003. In addition, these staffing cuts have come at a time when the IRS workload has dramatically increased.

According to IRS's own annual reports and data, taxpayers filed 114.6 million returns in 1995. After a steady annual climb, eight years later, the Service saw 130.3 million returns filed. In addition, between 1997 and 2005, the number of individual tax returns with $100,000 in reported income, which are generally more complex returns, increased by more than 52 percent. Yet, between 1995 and 2003, total numbers of employees shrunk from 114,000 to 94,000. Even more alarming is that during that period, revenue officers and revenue agents – two groups critical to reducing the tax gap – shrunk by 40 and 30 percent respectively. Revenue officers went from 8,139 to 5,004 and revenue agents fell from 16,078 to 11,513. Unfortunately, instead of reversing this trend, the IRS has continued efforts to reduce its workforce.

Just last year the IRS announced plans to eliminate 157 estate and gift tax lawyer positions – almost half of the agency's estate tax lawyers -- who audit some of the wealthiest Americans. The Service pursued this drastic course of action despite IRS reports that show tax evasion and cheating among the highest-income Americans is a serious and growing problem and internal data showing that estate and gift attorneys are the most productive enforcement personnel at the IRS collecting $2,200 in taxes for each hour of work. In addition, we have seen the focus of enforcement efforts turn away from high-income individuals and large corporations that account for a significant amount of unpaid taxes in recent years. IRS data shows that IRS audits of high-income individuals have dropped dramatically over the past decade. The audit rate for face-to-face audits fell from 2.9 percent of high-income tax filers in FY 1992 to 0.38

percent in FY 2001 and then drifted down to 0.35 percent in FY 2004. While the audit rate has rebounded somewhat in the last two years, it is still far below the level of the mid-1990's.

In addition, there are reports that top IRS officials are pushing auditors to prematurely close audits of large companies, leaving billions of dollars of taxes owed on the table. This disturbing fact is backed up by recent IRS data which shows the thoroughness of IRS enforcement efforts for the nation's largest corporations — measured by the number of hours devoted to each audit — has substantially declined since FY 2002. IRS data also show that the annual audit rate for these corporations, all with assets of $250 million or more, while increasing in FY 2004 and 2005, receded in 2006 to about the level it was in 2002 and is much lower than levels that prevailed a decade or more ago.

Although the number of the largest corporations is small, they are a very significant presence in the American economy. In FY 2002, the largest corporations were responsible for almost 75 percent of all additional taxes the IRS auditors said were owed the government. By comparison, low and middle income taxpayers in the same year were responsible for less than 10 percent of the total.

Despite this fact, agency data shows that audit attention given those with $250 million or more in assets has substantially declined in the last five years. In 2002, an average of 1,210 hours were devoted to each of the audits of the corporations in this category. And despite the IRS' efforts to increase "coverage" or the number of large corporations audited, the time devoted to each audit dropped sharply in 2004. By 2006 the number of hours per audit remained 20% below what it was in 2002.

Mr. Chairman, in the face of a rising tax gap and exploding federal deficits, it is imperative that the agency allow IRS professionals to pursue each and every dollar of the taxes owed by large corporations. Allowing these large corporations to pay just a fraction of what they owe in taxes greatly hinders efforts to close the tax gap and is fundamentally unfair to the millions of ordinary taxpayers that dutifully pay their taxes.

Mr. Chairman, it is clear that drastic reductions of some of the agency's most productive tax law enforcement employees has undermined agency efforts to close the tax gap and directly contradicts the Services' stated enforcement priority to discourage and deter non-compliance, particularly among high-income individuals.

NTEU's position on closing the burgeoning tax gap is supported by tax experts from both the Government Accountability Office and Citizens for Tax Justice, who recently told the Senate Budget Committee that adequate staffing and resources is "the most essential step that needs to be taken" to boost taxpayer compliance and reduce the tax gap.

NTEU Staffing Proposal

In order to address the staffing shortage at the IRS, NTEU supports a two percent annual net increase in staffing (roughly 1,885 positions per year) over a five-year period to gradually rebuild the depleted IRS workforce to pre-1998 levels. A similar idea was proposed by former IRS Commissioner Charles Rossotti in a 2002 report to the IRS Oversight Board. In the report, Rossotti quantified the workload gap in non-compliance, that is, the number of cases that should have been, but could not be acted upon because of resource limitations. Rossotti pointed out that in the area of known tax debts, assigning additional employees to collection work could bring in roughly $30 for every $1 spent. The Rossotti report recognized the importance of increased IRS staffing noting that due to the continued growth in IRS' workload (averaging about 1.5 to 2.0 percent per year) and the large accumulated deficit in work that should be done but could not be, even aggressive productivity growth could not possibly close the compliance gap. Rossotti also recognized that for this approach to work, the budget must provide for a net increase in staffing on a sustained yearly basis and not take a "one time approach." Because it takes time and careful management to hire, train, and deploy qualified professional staff, consistent but modest annual increases are necessary.

Although this would require a substantial financial commitment, the potential for increasing revenues, enhancing compliance and shrinking the tax gap makes it very sound budget policy. One option for funding a new staffing initiative would be to allow the IRS to hire personnel off-budget, or outside of the ordinary budget process. This is not unprecedented. In fact, Congress took exactly the same approach to funding in 1994 when Congress provided funding for the Administration's IRS Tax Compliance Initiative which sought the addition of 5,000 compliance positions for the IRS. The initiative was expected to generate in excess of $9 billion in new revenue over five years while spending only about $2 billion during the same period. Because of the initiative's potential to dramatically increase federal revenue, spending for the positions was not considered in calculating appropriations that must come within annual caps.

A second option for providing funding to hire additional IRS personnel outside the ordinary budget process could be to allow IRS to retain a small portion of the revenue it collects. The statute that gives the IRS the authority to use private collection companies to collect taxes allows 25 percent of collected revenue to be returned to the companies as payment, thereby circumventing the appropriations process altogether. Clearly, there is nothing magical about revenues collected by private collection companies. If those revenues can be dedicated directly to contract payments, there is no reason some small portion of other revenues collected by the IRS could not be dedicated to funding additional staff positions to strengthen enforcement.

But while NTEU agrees with IRS' stated goal of enhancing tax compliance and enforcement, we don't agree with the approach of sacrificing taxpayer service in order to pay for additional compliance efforts. NTEU believes providing quality services to taxpayers is an important part of any overall strategy to improve compliance and that reducing the number of employees dedicated to assisting taxpayers meet their obligations would only serve to exacerbate, not shrink, the tax gap. The Administration's own budget proposal for 2008 notes that in FY 2006, IRS' customer assistance centers answered almost 33 million assistor telephone calls and met the 82 percent level of service goal, with an accuracy rate of 91 percent for tax law questions. In addition, a recent study commissioned by the Oversight Board found that more than 80 percent of taxpayers contacted said that IRS service was better than or equal to service from other government agencies. And while these numbers show that IRS taxpayer services are being effective, more can and should be done.

Mr. Chairman, in order to continue to make improvements in taxpayer services while simultaneously processing a growing number of tax returns and stabilizing collections and examinations of cases, it is imperative to reverse the severe cuts in IRS staffing levels and begin providing adequate resources to meet these challenges. With the future workload expected to continue to rise, the IRS will be under a great deal of pressure to improve customer service standards while simultaneously enforcing the nation's tax laws. NTEU strongly believes that providing additional staffing resources would permit IRS to meet the rising workload level, stabilize and strengthen tax compliance and customer service programs and allow the Service to address the tax gap in a serious and meaningful way.

Private Tax Collection

Mr. Chairman, as stated previously, if provided the necessary resources, IRS employees have the expertise and knowledge to ensure taxpayers are complying with their tax obligations. That is why NTEU continues to strongly oppose the Administration's private debt collection program, which began in September of last year. Under the program, the IRS is permitted to hire private sector debt collectors to collect delinquent tax debt from taxpayers and pay them a bounty of up to 25 percent of the money they collect. NTEU believes this misguided proposal is a waste of taxpayer's dollars, invites overly aggressive collection techniques, jeopardizes the financial privacy of American taxpayers and may ultimately serve to undermine efforts to close the tax gap. We anticipate its complete failure as witnessed in a similar 1996 pilot program and will continue to work towards its repeal.

Let me be very clear: NTEU strongly believes the collection of taxes is an inherently governmental function that should be restricted to properly trained and proficient IRS personnel. When supported with the tools and resources they need to do their jobs, there is no one who is more reliable and who can do the work of the IRS better than IRS employees.

As you may know, under current contracts, private collection firms are eligible to retain 21% to 24% of what they collect, depending on the size of the case. By comparison, it only costs the government 3 cents for every dollar collected by an IRS employee. In testimony before Congress, the IRS Commissioner Mark Everson himself has twice acknowledged that using private collection companies to collect federal taxes will be more expensive than having the IRS do the work themselves. The Commissioner's admission directly contradicts one the Administration's central justifications for using private collection agencies --- that the use of private collectors is cost efficient and effective.

In addition to being fiscally unsound, the idea of allowing private collection agencies to collect tax debt on a commission basis also flies in the face of the tenets of the IRS Restructuring and Reform Act of 1998. Section 1204 of the law specifically prevents employees or supervisors at the IRS from being evaluated on the amount of collections they bring in. But now, the IRS has agreed to pay private collection agencies out of their tax collection proceeds, which will clearly encourage overly aggressive tax collection techniques, the exact dynamic the 1998 law sought to avoid. Furthermore, the IRS is turning over tax collection responsibilities to an industry that has a long record of abuse. For example, in 2005 (the latest year statistics are available), the Federal Trade Commission received 66,627 consumer complaints about debt collection agencies – giving debt collectors the impressive title of the FTC's most complained-about industry.

NTEU believes that a better option would be to provide the IRS with the resources and staffing it needs. There is no doubt that IRS employees are – by far – the most reliable, cost-effective means for collecting federal income taxes. As noted previously, the IRS Commissioner himself has admitted that using IRS employees to collect unpaid tax debts is more efficient than using private collectors. In addition, the 2002 budget report submitted to the IRS Oversight Board, former Commissioner Charles Rossotti made clear that with more resources to increase IRS staffing, the IRS would be able to close the compliance gap.

This is not the first time the IRS has tried this flawed program. Two pilot projects were authorized by Congress to test private collection of tax debt for 1996 and 1997. The 1996 pilot was so unsuccessful it was cancelled after 12 months, despite the fact it was authorized and scheduled to operate for two years. A subsequent review by the IRS Office of Inspector General found that contractors participating in the pilot programs regularly violated the Fair Dept Collection Practices Act, did not adequately protect the security of personal taxpayer information, and even failed to bring in a net increase in revenue. In fact, a 1997 GAO report found that private companies did not bring in anywhere near the dollars projected, and the pilot caused a $17 million net loss.

And despite IRS assurances that it has learned from its past mistakes, two recent reports indicate otherwise. A March 2004 report by the Treasury Inspector General for Tax Administration raised a number of questions about IRS' contract administration and oversight of contractors. The report found that "a contractor's employees committed numerous security violations that placed IRS equipment and taxpayer data at risk" and in some cases, "contractors blatantly circumvented IRS policies and procedures even when security personnel identified inappropriate practices." (TIGTA Audit #200320010). The proliferation of security breaches at a number of government agencies that put personal information at risk further argue against this proposal. These security breaches illustrate not only the risks associated with collecting and disseminating large amounts of electronic personal information, but the risk of harm or injury to consumers from identity theft crimes.

In addition, a September 2006 examination of the IRS private collection program by the Government Accountability Office (GAO) reveals that like the 1996 pilot, the program may actually lose money by the scheduled conclusion of the program's initial phase in December 2007. The report cited preliminary IRS data showing that the agency expects to collect as little as $56 million through the end of 2007, while initial program costs are expected to surpass $61 million. What's more, the projected costs do not even include the 21-24 percent commission fees paid to the collection agencies directly from the taxes they collect.

In addition to the direct costs of the program, I am greatly concerned about the potential negative effect that the private tax collection program will have on our tax administration system. In her recent report to Congress, the National Taxpayer Advocate voiced similar concern about the unintended consequences of privatizing tax collection. Olson cited a number of "hidden costs" that private tax collection has on the tax system including reduced transparency of IRS tax collection operations, inconsistent treatment for similarly situated taxpayers, and reduced tax compliance. Clearly the negative effects of contracting out tax collection to private collectors hampers the agency's ability to improve taxpayer compliance and will only serve to undermine future efforts to close the tax gap.

NTEU is not alone in its opposition to the IRS' plan. Similar proposals allowing private collection agencies to collect taxes on a commission basis have been around for a long time and have consistently been opposed by both parties. In fact, the Reagan Administration strongly opposed the concept the concept of privatizing tax collections warning of a considerable adverse public reaction to such a plan, and emphasizing the importance of not compromising the integrity of the tax system. (Treasury Dept. Statement to House Judiciary Comm. 8/8/86). More recently, opposition to the private debt collection program has been voiced by a growing number of members of Congress, major public interest groups, tax experts, as well as the Taxpayer Advocacy Panel, a volunteer federal advisory group—whose members are appointed by the IRS and the Treasury Department. In addition, the National Taxpayer Advocate, an independent official within the IRS recently identified the IRS private debt collection initiative as one of the most serious problems facing taxpayers and called on Congress to immediately repeal the IRS' authority to outsource tax collection work to private debt collectors (National Taxpayer Advocate 2006 Report to Congress).

Instead of rushing to privatize tax collection functions which jeopardizes taxpayer information, reduces potential revenue for the federal government and undermine efforts to close the tax gap, the IRS should increase compliance staffing levels at the IRS to ensure that the collection of taxes is restricted to properly trained and proficient IRS personnel.

Mr. Chairman, NTEU believes that frontline IRS employees are the best defense against an increasing U.S. tax gap. But it is up to the Administration to request the funding necessary for these employees to do their job and then up to the IRS to utilize these employees to their fullest potential. Without a doubt, rank and file employees are committed to working with management to increase efficiency and customer satisfaction while decreasing the U.S. tax gap. If the Administration and Congress are serious about lessening the tax gap, it will provide IRS with the necessary staffing and a dedicated funding stream to support those additional workers.