

**HEARING BEFORE THE  
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM  
SUBCOMMITTEE ON  
GOVERNMENT ORGANIZATION, EFFICIENCY, AND  
FINANCIAL MANAGEMENT  
U.S. HOUSE OF REPRESENTATIVES**

“Problems at the Internal Revenue Service: Closing the  
Tax Gap and Preventing Identity Theft”



**Testimony of  
The Honorable J. Russell George  
Treasury Inspector General for Tax Administration**

**April 19, 2012**

**Washington, D.C.**

TESTIMONY OF  
THE HONORABLE J. RUSSELL GEORGE  
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION  
*before the*  
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM  
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and Preventing Identity Theft”

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Chairman Platts, Ranking Member Towns, and Members of the Subcommittee, I thank you for the opportunity to testify on the Tax Gap and the efforts by the Internal Revenue Service (IRS) to enforce compliance with the tax code. My comments will focus on how the Treasury Inspector General for Tax Administration (TIGTA) provides oversight of the IRS’s efforts to ensure that taxpayers comply with their tax obligations, as well as what the IRS is doing to address the growing risk of identity theft and tax fraud.

The IRS defines the Tax Gap as the difference between the estimated amount taxpayers owe<sup>1</sup> and the amount they voluntarily and timely pay for a tax year. In January 2012, the IRS released updated estimates of the Tax Gap for Tax Year (TY)<sup>2</sup> 2006, which indicated that the Nation’s voluntary compliance rate was essentially unchanged from the prior estimates. The IRS states that the increase in the dollar amount is due almost entirely to the increase in total tax liabilities over the intervening period and does not reflect any significant change in compliance rates. The following table shows the comparison between the prior and the current Tax Gap estimates.

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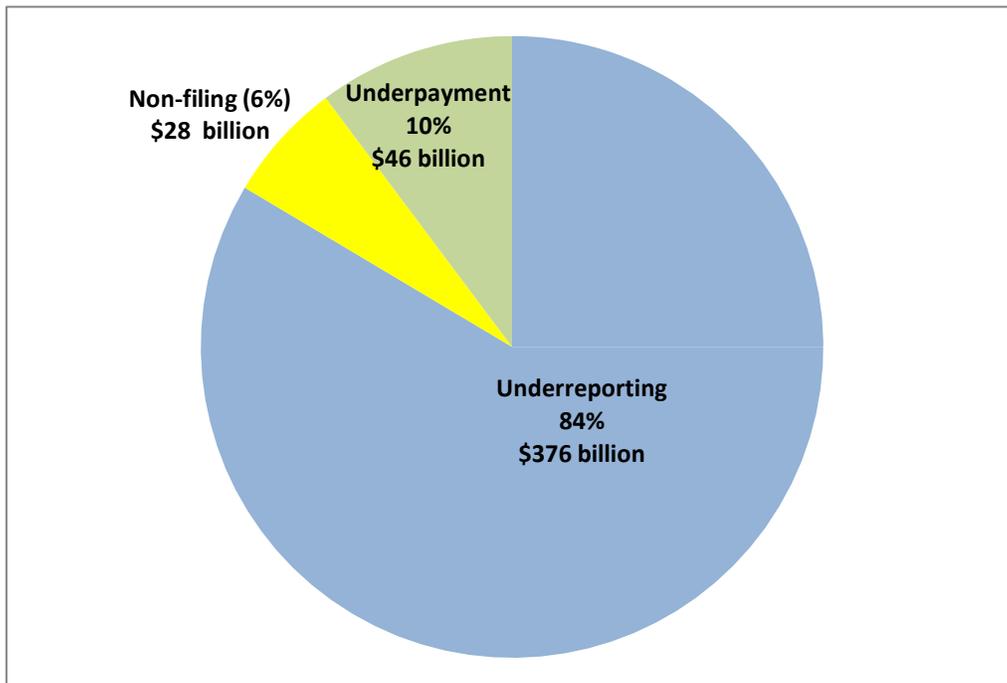
<sup>1</sup> This includes all types of tax liabilities, including: Individual Income Tax, Corporation Income Tax, Employment Tax, Estate Tax, and Excise Tax.

<sup>2</sup> A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

	<b>Tax Year 2001 (billions)</b>	<b>Tax Year 2006 (billions)</b>
Total Tax Liabilities	\$2,112	\$2,660
Gross Tax Gap	\$345 (83.7% compliance)	\$450 (83.1% compliance)
Enforcement and Late Payments	\$55	\$65
Net Tax Gap	\$290	\$385

The Gross Tax Gap is defined as the amount of true tax liability that taxpayers do not pay on time. The Net Tax Gap is defined as the amount of true tax liability that is not paid on time and is not collected subsequently, either voluntarily or as the result of enforcement activities.

The IRS reports that the Gross Tax Gap is comprised of three primary components:



Underreporting of tax liabilities. Of the \$450 billion gross Tax Gap in TY 2006, \$376 billion (approximately 84 percent) is estimated to result from the underreporting of tax liabilities. Specifically, the underreporting Tax Gap (henceforth the “underreporting gap”) is defined as the amount of tax liability

not voluntarily reported by taxpayers who file required returns on time. For income taxes, the underreporting gap arises from three types of errors: underreporting taxable income, overstating offsets to income or to tax, and net math errors. Taxable income includes such items as wages and salaries, rents and royalties, and net business income. Offsets to income include income exclusions, exemptions, statutory adjustments, and deductions. Offsets to tax are tax credits. Net math errors involve mathematical mistakes or transcription errors made by taxpayers that are corrected at the time the return is processed. In addition to developing an estimate of the aggregate underreporting gap, it is possible to break aspects of this estimate down into measures of the underreporting gap attributable to specific line items on the tax return.

Non-filing of tax returns. Of the \$450 billion gross Tax Gap in TY 2006, \$28 billion (approximately 6 percent) is estimated to be associated with tax returns that were filed after the filing deadline (or valid extension date) or were not filed at all. It is reduced by amounts paid on time, such as through withholding, estimated payments, and other credits. However, it does not include legitimate nonfilers (i.e., those who have no obligation to file).

Underpayment of tax liabilities. For TY 2006, \$46 billion of taxes reported on time were not paid when due. Stated another way, the underpayment gap is the portion of the total tax liability that taxpayers report on their timely filed returns but do not pay on time. This arises primarily from insufficient remittances from taxpayers themselves. However, it also includes employer under-deposits of withheld income tax. In the case of withheld income tax, employees have the responsibility to report the corresponding tax liability on timely filed returns, and employers are responsible for depositing those withholdings with the Government on time.

The IRS reported that the growth in the Tax Gap from TY 2001 to 2006 was concentrated in the underreporting and underpayment forms of noncompliance, which jointly account for more than nine out of ten Tax Gap dollars. The underreporting gap grew by 32 percent and the underpayment gap grew by 38 percent. In contrast, the nonfiling gap grew by only 4 percent.

The IRS further reported that more than a third of the growth in the underreporting gap was attributable to corporate income taxes. Several factors contributed to this increase: First, the 2001 estimate was calculated based on old data and was likely understated. Second, the new estimate relied on more recent and

improved data. And finally, between TY 2001 and 2006, corporate income tax liabilities more than doubled, while the individual income taxes grew by only 15 percent.

Compliance is far higher when reported amounts on tax returns are subject to information reporting and withholding. For example, when there is substantial information reporting and withholding<sup>3</sup> the compliance rate is 99 percent. For amounts subject to substantial information reporting but not withholding,<sup>4</sup> the rate is 92 percent. For amounts subject to little or no information reporting, such as business income, the rate is only 44 percent.

The IRS reported that for TY 2006, the amount of enforced and other late payments it will eventually collect is estimated to be \$65 billion. Both types of payments were estimated using IRS data of prior revenue and late payments received. However, the IRS does not have good data on the amounts that are paid late without enforcement efforts, and amounts to be collected in future years were estimated using data on payment patterns from earlier years.

The IRS uses a variety of techniques to identify unpaid tax liabilities, including (1) identifying taxpayers who file tax returns without fully paying the tax reported to be owed, (2) checking for obvious errors when processing returns, (3) finding additional tax liabilities by auditing a filed tax return, (4) assessing a penalty for some taxpayer action or inaction, and (5) sending a bill to a taxpayer who did not file a required tax return.

If the taxpayer does not cooperate, the IRS may take enforced collection action. Enforcement action could include serving a notice of levy that is attached to the taxpayer's income or assets such as bank accounts. In some cases, the IRS will take enforcement action by seizing and selling property. The IRS takes these actions only after giving the taxpayer an opportunity to voluntarily pay the debt, make arrangements to pay, or supply information to show that payment would create a hardship.

In the IRS's 2007 report on *Reducing the Federal Tax Gap*, the IRS states that voluntary compliance rates appear to have remained relatively stable at around 85 percent for decades. The report further states that to make a meaningful improvement in this rate will require a long-term, focused effort involving taxpayer service, modernization, and enforcement. The Department of the Treasury's 2006 report, *A Comprehensive Strategy for Reducing the Tax Gap*, describes the extensive challenges to reducing the Tax Gap. According to the report, addressing the Tax Gap involves improving voluntary compliance, reducing opportunities for evasion through legislative

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<sup>3</sup> Wages and salaries.

<sup>4</sup> Pensions and annuities, unemployment compensation, dividend and interest income, Social Security benefits.

proposals, and making it easier for the IRS to administer the tax laws, accompanied by broader simplification and reform of the tax code and significant advances in compliance technology.

The IRS also reported that the Tax Gap is caused by both unintentional taxpayer errors (whether due to tax law complexity, confusion, ignorance, or carelessness) and willful tax evasion or cheating, although the IRS does not have sufficient data to distinguish the amounts attributable to each. In addition, a wide range of factors influence voluntary compliance, including tax law changes, the economy, and changing demographics of the taxpayer population. There are also indirect effects of IRS enforcement activities beyond the direct effects of additional revenue collections. These refer to “spillover” effects when enforcement activity on one set of taxpayers has positive effects on the compliance behavior of the rest of the taxpayer population in response to heightened enforcement activity. However, the IRS also stated that it is very difficult to determine the impact that any IRS activity has on voluntary compliance.

From the perspective of tax administration, the IRS also needs to overcome institutional impediments to more effectively address the Tax Gap. These impediments refer to the established policies, practices, technologies, business processes or requirements that add unintended costs or are no longer optimal given changes to strategies, goals, and technologies. TIGTA’s perspective is that the current institutional impediments the IRS faces can point the way to improvement opportunities, to wit:

**Incomplete compliance research** that does not identify all the sources of noncompliance so that IRS resources can be targeted properly. The IRS reported that new research is needed on the relationship between taxpayer burden and compliance and on the impact of customer service on voluntary compliance. Additional research would also assist in establishing benchmarks and measures to assess the effectiveness of IRS efforts to address taxpayer compliance.

**Insufficient compliance strategies** that do not always address the areas of highest risk of noncompliance. The IRS’s systems that identify returns for examination need improvement. IRS examinations continue to result in no change to the return, resulting in an inefficient use of examination resources and increased burden on compliant taxpayers. In addition, IRS collection activity that extends for years has a lower rate of collection for delinquent liabilities. The IRS reported it is working to reengineer examination and collection procedures based on improved data from its National Research Project study of individual taxpayers. This effort, coupled with investments in

technology, should result in efficiency gains and better targeting of examination efforts. These efficiency gains translate into expanded examination coverage, higher audit yields, and reduced burden on compliant taxpayers.

**Incomplete document matching programs** because the IRS does not have reliable third-party data for all taxpayer sectors and for all types of tax returns, most notably income earned by the self-employed. The IRS reported that, without this data, it cannot easily detect errors or potential fraud except through expensive and intrusive examinations.

**Insufficient enforcement resources** to handle a growing caseload. The IRS has identified noncompliance and potential fraud cases it did not have the resources to work, allowing billions of dollars to be fraudulently refunded each year.<sup>5</sup> In addition, in Fiscal Year<sup>6</sup> (FY) 2010, the Collection function was unable to work all of the existing accounts in the Queue<sup>7</sup> with current staffing, and the number of new taxpayer delinquent accounts was outpacing closures. If changes do not occur, a significant number of cases will continue to not receive additional contact to resolve the tax delinquency.<sup>8</sup>

The IRS often faces constant changes as a result of temporary tax provisions and new tax law. For example, during FY 2010, the IRS encountered many challenges, including a variety of tax provisions that were created, extended, or expanded. Specifically, the provisions were the:

**American Recovery and Reinvestment Act of 2009 (Recovery Act).**<sup>9</sup> The Recovery Act included 56 tax provisions (20 related to individual taxpayers and 36 related to business taxpayers). These provisions will continue to challenge the IRS over multiple filing seasons.

**Worker, Homeownership, and Business Assistance Act of 2009.**<sup>10</sup> The Worker, Homeownership, and Business Assistance Act of 2009 revised, extended, and expanded the First-Time Homebuyer Credit (Homebuyer

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<sup>5</sup> TIGTA, Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year* (February 2011).

<sup>6</sup> A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.

<sup>7</sup> An automated holding file for unassigned inventory of delinquent cases for which the Collection function does not have enough resources to immediately assign the cases for contact.

<sup>8</sup> TIGTA, Ref. No. 2011-30-071, *Trends in Compliance Activities Through Fiscal Year 2010* (July 2011).

<sup>9</sup> Pub. L. No. 111-5, 123 Stat. 12984.

Credit) to a broader range of home purchases and added new documentation requirements. Initially, the IRS did not have math error authority<sup>11</sup> to disallow the Homebuyer Credit during processing if documentation was not provided. Congress has since passed legislation requiring documentation for the Homebuyer Credit and provided the IRS with math error authority to disallow the Credit if the documentation was not provided.

**Hiring Incentives to Restore Employment Act of 2010 (HIRE Act).**<sup>12</sup> The HIRE Act enacted tax benefits to employers who expanded payrolls and hired previously unemployed individuals. Eligible business taxpayers will be exempt from their share of Social Security taxes on wages to eligible employees. These taxpayers may also be eligible for a credit of up to \$1,000 for qualified employees. Additionally, Title V of the HIRE Act included the Foreign Account Tax Compliance Act. A provision of this Act included the requirement that individual taxpayers indicate on their income tax returns the maximum value of foreign financial assets held during the tax year. This provision will allow the IRS to increase enforcement on taxpayers hiding assets overseas.

**Patient Protection and Affordable Care Act of 2010 (Affordable Care Act).**<sup>13</sup> At least 42 of the 514 Affordable Care Act provisions add to or amend the Internal Revenue Code, and at least eight require the IRS to establish new operations. Collectively, these provisions represent the largest set of tax law changes in 20 years. The Affordable Care Act contains \$438 billion of revenue provisions in the form of new taxes and fees. It also contains credits which provide incentives for medical research and for businesses to offer employees health care insurance. Additionally, new reporting requirements have been established for certain business transactions. The Affordable Care Act further imposes penalties administered through the tax code for individuals and businesses that do not obtain health coverage for themselves or their employees. Other provisions raise revenue to help pay for the overall cost of health insurance reform.

These tax provisions are examples of the impact that tax law changes have on how the IRS conducts its activities, how many resources are required, and how quickly or whether the IRS can meet strategic goals. The IRS has the challenging task of

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<sup>11</sup> This is a program in which the IRS contacts taxpayers through the mail or by telephone when it identifies mathematical errors or mismatches of taxpayer information that would result in a tax change.

<sup>12</sup> Pub. L. No. 111-147, 124 Stat. 71.

<sup>13</sup> Pub. L. No. 111-148, 124 Stat. 119.

maintaining a quality workforce and enforcing tax laws in an environment of constantly changing tax legislation.

The IRS also faces significant challenges in obtaining complete and timely compliance data and in developing methods necessary to interpret the data. Despite a 19 percent increase in enforcement staffing levels since FY 2006 and the IRS's more vigorous use of collection enforcement tools, FY 2010 enforcement results were mixed when compared to FY 2009 results. The number of delinquent accounts closed by full payment and the amount collected on delinquent accounts increased. However, the Collection function received more delinquent accounts than it closed, gross accounts receivable rose, and the number of tax delinquency investigation cases<sup>14</sup> closed with the receipt of a delinquent tax return fell.<sup>15</sup> In addition, there were increases in the number of delinquent accounts that may never be worked because they were shelved or surveyed and in accounts receivable. For examinations, the large staffing level increases in FY 2009 and FY 2010 resulted in the most tax returns examined in the past five years. The dollar yield per hour for examinations increased in FY 2009 but decreased in FY 2010. In addition, the no-change rates<sup>16</sup> for several types of examinations increased in FY 2010 compared to FY 2009. The IRS continues to conduct studies with the goal of improving the return selection process to increase rates of return across the enforcement program.

One means the IRS employs to collect unpaid taxes is the notice stream.<sup>17</sup> The notice stream is the least costly of the IRS's approaches to collecting unpaid taxes. While the notice stream collects billions of dollars in delinquent taxes annually, reducing the time between notices could result in the annual collection of millions of dollars more. During FY 2010, the IRS sent approximately 21.9 million balance-due notices to individuals to attempt to collect unpaid taxes. By a wide margin, the first notice (also known as the Master File notice) closed the most cases, collected the most money, and generated the highest number of taxpayer responses. Cases not resolved after the Master File notice continue in the notice stream, and those taxpayers receive various sequences of notices. The IRS allows 35 days between notices for the taxpayer to respond, but TIGTA's analysis shows that the time between notices can be reduced. As these balance due modules progress within the notice stream, the probability of collection diminishes.

TIGTA recommended that the IRS consider reducing the time between each notice by seven days. This could result in the potential collection of as much as \$363

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<sup>14</sup> An unfiled tax return for a taxpayer. One tax delinquency investigation case exists for all tax periods.

<sup>15</sup> TIGTA, Ref. No. 2011-30-071, *Trends in Compliance Activities Through Fiscal Year 2010* (July 2011).

<sup>16</sup> Percentage of examinations where the examiner closed the case with no recommended tax change.

<sup>17</sup> A series of balance-due notices sent by the IRS to the taxpayer to prompt payment.

million more each year. In addition, taxpayers could potentially save \$1.8 million each year in interest payments. The IRS agreed with TIGTA's recommendations and plans to take corrective actions. However, in its response, the IRS stated that 35 days between notices were necessary to process taxpayer inquiries and correspondence. TIGTA's report noted that the IRS has controls in place to prevent the next notice from being sent when taxpayers' correspondence is being processed.<sup>18</sup>

The IRS reported the following initiatives that it has begun to implement to address the Tax Gap:

### **Tax Return Preparers**

Every year, more than one-half of all taxpayers pay someone else to prepare their Federal income tax returns. During the 2011 Filing Season,<sup>19</sup> the IRS processed approximately 66.9 million individual Federal income tax returns prepared by paid tax return preparers.

In December 2009, the IRS announced a suite of proposed reforms to improve oversight of the return preparer community. TIGTA is monitoring the IRS's implementation of the new Return Preparer Program. In September 2011, TIGTA reported that it will take years for the IRS to implement the Return Preparer Program and to realize its impact.<sup>20</sup> When the decision was made to register preparers, the IRS had not established all of the program requirements. The IRS also had not: (1) established the organizational structure of the program, (2) determined how it will verify that all preparers met the requirements, (3) determined how it will enforce program requirements, or (4) developed the system(s) and processes necessary to administer and oversee the program. It will not be until Calendar Year<sup>21</sup> 2014 that all preparers will be subjected to all suitability and competency tests. In the meantime, IRS management stated they will develop and implement an enforcement strategy. Currently, the IRS does not have a sufficient management information system to gather data on preparers. Further, the IRS will need to ensure that taxpayers understand the new requirements and the importance of using only registered preparers to prepare their tax returns.

Of the 66.9 million individual Federal income tax returns prepared by paid tax return preparers and processed by the IRS in Calendar Year 2011, 90 percent were e-

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<sup>18</sup> TIGTA, Ref. No. 2011-30-112, *Reducing the Processing Time Between Balance Due Notices Could Increase Collections* (September 2011).

<sup>19</sup> The period from January 1 through April 15 when most individual income tax returns are filed.

<sup>20</sup> TIGTA, Ref. No. 2010-40-127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (September 2010).

<sup>21</sup> The 12-consecutive-month period ending on December 31.

filed.<sup>22</sup> In November 2009, Congress approved a Federal e-file mandate for tax return preparers. TIGTA's review of the IRS's implementation of the mandate found that for the first few years, the IRS plans to use a "soft" approach to enforcement that emphasizes educating and collaborating with preparers in implementing e-file requirements. Additionally, the continued use of multiple preparer identification numbers makes it difficult to match all tax returns to the preparers. However, improvements are under way to ensure the effectiveness of controls and system validations over the preparer registration process.

TIGTA recommended several actions, including that the IRS monitor preparers' compliance with the e-file mandate and ensure that suitability tests match applicants to IRS information to identify preparers who are not allowed to prepare tax returns. IRS management agreed and stated that corrective actions to address the recommendations have been taken or are planned.

The IRS reported that this compliance strategy will cut down on inaccurate and fraudulent returns. It also makes it easier for the IRS to catch unscrupulous return preparers. In addition, these efforts will help improve service to taxpayers and assist with voluntary compliance.

### **Basis Reporting**

Third-party reporting and transparency is also crucial to high compliance among individual taxpayers. Basis reporting associated with the buying and selling of securities was an area that needed third-party reporting based on previous studies that showed low levels of compliance.

The IRS issued proposed regulations in 2009 and final regulations in 2010 under a new law<sup>23</sup> that will require reporting by stock brokers and mutual fund companies on an investor's adjusted basis and whether any gain or loss on the sale is classified as short-term or long-term for most stock purchased in 2011 and all stock purchased in 2012 and later years. Such reports will be made available to investors and the IRS.

### **Business Taxes**

Third-party reporting and transparency are hallmarks of high levels of tax compliance. The IRS undertook several initiatives in recent years to improve those

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<sup>22</sup> As of May 4, 2011.

<sup>23</sup> Energy Improvement and Extension Act of 2008, Pub. L. No. 110-343, § 403, 122 Stat. 3765, 3854-3858.

aspects in the world of business taxes, where the efficient allocation of limited resources is particularly important to sound tax administration.

New merchant card reporting requirements<sup>24</sup> were established for TY 2011. They provide third-party reporting data on business receipts for the first time, making it easier for the IRS to identify businesses that are either under-reporting receipts or not reporting at all. The IRS issued final regulations in 2010 and the new reporting requirements took effect on January 1, 2011. In general, these requirements apply to government entities and private businesses, as well as most types of payment cards, such as credit and debit cards.

In an effort to achieve greater transparency, the IRS also requires the reporting of certain tax avoidance transactions that have the potential to be abusive. These transactions are called “listed” transactions and also include other types of transactions that are the same or substantially similar to the listed transactions. Taxpayers are required to disclose their participation in listed transactions or they may be subject to penalties. In FY 2010, the IRS received approximately 35,000 of the disclosure documents.

### **International Compliance Efforts**

Globalization of the U.S. economy has been a major trend for many years. International business holdings and investment in the United States have grown from nearly \$188 billion in 1976 to over \$14.5 trillion in 2007, while U.S. business and investment worldwide grew from nearly \$368 billion to nearly \$15 trillion over the same period. The scope and complexity of the international financial system create significant enforcement challenges for the IRS. The IRS continues to be challenged by a lack of information reporting on many cross-border transactions. In addition, the varying legal requirements imposed by different jurisdictions result in complex business structures that make it difficult to determine the full scope and effect of these cross-border transactions. Technological advances also provide opportunities for offshore investments that were once only possible for large corporations and wealthy individuals.

Over the past few years, the IRS has taken steps and made strategic internal realignments to better coordinate international tax compliance issues. It has developed a strategic plan specifically for international tax issues with two major goals: 1) enforce the law to ensure that all taxpayers meet their obligation to pay U.S. taxes and 2)

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<sup>24</sup> Housing and Economic Recovery Act of 2008, sec. 3091, § 6050W, 112 Stat. 2654, 2908-2911.

improve service to make voluntary compliance less burdensome. In November 2009, the IRS's Global High Wealth unit began operation. It was formed to better cope with the growing complexity of income and assets of the high-income, high-wealth population. In August 2010, the IRS realigned its international efforts under its Large Business and International (LB&I) Division, which was designed to strengthen international tax enforcement in several ways, including identifying emerging international compliance issues more quickly and ensuring the right compliance resources are allocated to the right cases. During FY 2012, the IRS will merge the Office of Chief Counsel's Advanced Pricing Agreement Program with the LB&I Division's Mutual Agreement Program to form the Advanced Pricing and Mutual Agreement Program. This combined program will be a component of the LB&I Division's Transfer Pricing Operations. The IRS expects that efforts like these will improve international tax compliance by allowing it to focus on high-risk issues and cases with greater consistency and efficiency.

The Congress, the Department of the Treasury, and the IRS are concerned about the International Tax Gap – that is, taxes owed, but not collected on time, from a U.S. or nonresident person whose cross-border income is subject to U.S. taxation. The IRS has not estimated the size of the International Tax Gap, but non-IRS estimates range from \$40 billion to \$123 billion<sup>25</sup> annually. While there might be overlap between the overall IRS Tax Gap estimate and the International Tax Gap estimate, it is unlikely that the \$450 billion Tax Gap estimate includes the entire International Tax Gap. The primary reason for this is that identifying hidden income within international activity is very difficult and time-consuming.<sup>26</sup>

The IRS's strategic initiatives focus on strengthening reporting requirements, enhancing IRS access to international data, and aligning resources to cases and issues with the highest compliance risk. One reporting requirement is the *Report of Foreign Bank and Financial Accounts* (FBAR) report, which is an information report required when U.S. citizens, residents, and domestic entities owns or has signature or other authority over foreign financial accounts worth over \$10,000 in any calendar year. Congress set up FBAR penalties because some taxpayers use these foreign accounts to evade U.S. taxation.

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<sup>25</sup> TIGTA, Ref. No. 2009-IE-R001, *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap* (January 2009).

<sup>26</sup> GAO, Ref. No. GAO-07-237, *Tax Administration: Additional Time Needed to Complete Offshore Tax Evasion Examinations* (March 2007).

In addition, the Foreign Account Tax Compliance Act (FATCA)<sup>27</sup> requires foreign financial institutions to report to the IRS information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. FATCA will be phased in by the IRS in the next several years. Individual taxpayers with an aggregate balance of more than \$50,000 in foreign financial assets are required to file a disclosure statement with their income tax return.

In August 2010, TIGTA reported that taxpayers excluded \$19.2 billion in foreign earned income on TY 2008 tax returns. Our review identified 23,334 tax returns with erroneous foreign earned income tax exclusions totaling \$675 million, with an estimated revenue loss of \$90 million. Over five years, TIGTA estimated erroneous claims could result in a total revenue loss of \$450 million. Some of the recommendations that TIGTA provided were that the IRS:

Review the tax returns of those individuals that TIGTA identified as incorrectly claiming the foreign earned income exclusion;

Establish a unit to address taxpayers identified as erroneously claiming the foreign earned income exclusion;

Assess whether compliance project criteria can be used to identify erroneous claims during tax return processing; and

Include programming to forward tax returns (both electronically filed and paper) for correction when individuals incorrectly compute their foreign earned income exclusion.

IRS management agreed with most of the recommendations, but they stated that substantial barriers prevented the implementation of certain recommendations at the time of the review. TIGTA is concerned that the lack of corrective actions will allow continued revenue loss.<sup>28</sup>

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<sup>27</sup> In 2010, FATCA was enacted as part of the Hiring Incentives to Restore Employment (HIRE) Act, Pub. L. No. 111-147, 124 Stat. 71, 97-117.

<sup>28</sup> TIGTA, Ref. No. 2010-40-091, *Improvements Are Needed to Reduce Erroneous Foreign Earned Income Exclusion Claims* (August 2010).

## **Offshore Tax Avoidance**

Stopping offshore tax cheating and getting these people, especially high net-worth individuals, back into the tax system has been a top priority of the IRS. The IRS continues to work with the U.S. Department of Justice on tax evasion cases involving foreign countries with bank secrecy laws that prevent the United States from obtaining information on taxpayer transactions. In addition, both the 2009 and 2011 Offshore Voluntary Disclosure Initiatives have encouraged taxpayers with hidden offshore assets and income to come back into the tax system using the IRS's Voluntary Disclosure Program. According to the IRS, these initiatives have resulted in the collection of over \$4 billion. Due to the success of the first two initiatives, the IRS is currently offering a third chance for delinquent taxpayers to disclose their hidden offshore assets. These initiatives are beneficial because they offer a uniform penalty structure for taxpayers who voluntarily disclose their hidden offshore assets and income to the IRS and, in return, ensure that the taxpayers receive consistent tax and penalty treatment.

The initiatives also provide the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all outstanding offshore tax issues related to the undisclosed foreign bank and financial accounts and assets. On the other hand, taxpayers with undisclosed foreign accounts and assets who do not submit a voluntary disclosure run the risk of detection by the IRS. If caught, these taxpayers face the imposition of substantial penalties, including the fraud and foreign information return penalties, as well as an increased risk of criminal prosecution.

## **Real-Time Tax System**

The IRS has started work exploring how to implement a series of long-term changes to the tax system which will result in higher compliance. Commissioner Shulman has described a vision where the IRS would move away from the traditional "look-back" model of compliance, and instead endeavor to conduct its compliance efforts in "real time," such as by matching third-party information with information provided by the taxpayer when the tax returns are first filed with the IRS. The goal of this initiative is to improve the tax filing process by reducing burden for taxpayers and improving overall compliance "up front," during the filing season instead of later through compliance or enforcement activities. In addition, the IRS plans to include more data mining and predictive analytics in this initiative, to improve identification of noncompliance and potential tax fraud.

In FY 2012, the IRS has delivered significant updates to its core tax processing system, transitioning to a daily processing cycle for individual returns. Also, IRS

processing systems are accepting all Forms 1040, U.S. Individual Income Tax Return, electronically through an updated e-filing capability. This capability is designed to eventually feed into a single, consolidated taxpayer account database that will support the deployment of the next generation of taxpayer service and enforcement functions.

TIGTA has reviewed a number of other IRS challenges in addressing the Tax Gap. One important aspect involves human capital. Like many Federal agencies, the IRS is faced with the major challenge of replacing existing talent caused by a large number of retirements expected over the next several years. In five years, about one-third of the IRS's workforce of approximately 100,000 employees will be retirement eligible. This statistic is even more pronounced in the leadership ranks, where over two-thirds of IRS executives will be retirement eligible in five years. Adding to this challenge, the IRS offered early retirement and buyouts to more than 2,200 employees in FY 2011. Replacing these employees provides an opportunity for reshaping the IRS workforce, but also represents a significant challenge since many departing employees possess unique skills and institutional knowledge that will be difficult to replace.

Revenue officers (RO) have a direct impact on the IRS's ability to meet its mission by collecting the appropriate amount of tax due. The IRS added 1,515 new ROs during the period June 2009 through February 2010, but it still struggles to keep pace with attrition and workload. If the IRS does not have a sufficient number of qualified ROs to collect delinquent taxes, it could create an unfair burden on the majority of taxpayers who fully pay their taxes on time. However, when estimating the staffing levels of ROs, the IRS does not determine the number needed to address the available workload. Instead, the IRS bases the RO staffing level primarily on a budget figure. The IRS believes there is more than enough inventory to justify staffing increases. However, the IRS does not know when hiring additional ROs will no longer be needed.

The IRS's FY 2009 budget justification projected that the RO hiring initiative would allow 88,000 additional delinquent account closures, resulting in \$333.6 million in additional revenue for FY 2011. However, the IRS does not track a comparison of actual results to the original projections in the years following the budget's implementation. As a result, it is unknown if the IRS realized all or part of the additional projected revenue for this initiative, and the IRS lost an opportunity to collect information that could help improve future budgets. TIGTA recommended that the IRS:

Establish rules for optimizing staffing levels for ROs to address Collection's potentially collectible inventory; and

Develop methods to track actual results with projected benefits in future budget justifications.

IRS management agreed to review workload and resource levels to improve future resource allocation and staffing decisions. IRS management also stated that they initiated efforts in 2010 to develop a methodology to determine the actual revenue collected from specific enforcement initiatives proposed in the IRS's FY 2009 budget justification. However, this information was not shared with TIGTA during the review. As a result, TIGTA did not assess whether those efforts addressed the recommendation.<sup>29</sup> Until IRS management implements this type of methodology, they will not know the actual additional revenue realized from requested enforcement initiatives.

The misclassification of millions of employees as independent contractors is a nationwide problem that continues to grow and contribute to the \$72 billion underreporting Employment Tax Gap. In a report issued in Fiscal Year 2010,<sup>30</sup> TIGTA determined that the IRS has opportunities to enhance compliance in its Employment Tax Program by: 1) taking measures to ensure employment tax forms are not misused to avoid paying taxes, and 2) regularly sharing the results of worker classification examinations between IRS compliance functions to ensure the greatest possible use of the agency's resources when addressing the underreporting Tax Gap. TIGTA identified more than 74,000 taxpayers who may have avoided paying approximately \$26 million in Social Security and Medicare taxes in Processing Year<sup>31</sup> 2008.

Another of the IRS's priorities is combating tax avoidance transactions.<sup>32</sup> However, the IRS has identified tax returns with tax avoidance transaction issues that do not warrant examination before taxpayer contact, a process known as surveying. Surveying tax returns with a tax avoidance transaction issue without proper justification or approval could be counterproductive to the IRS's goal to combat abusive schemes. In addition, this approach can erode the public's confidence in the IRS's ability to enforce tax laws in a fair, equitable, and consistent manner. As a result, TIGTA recommended that the IRS:

Develop internal controls and train employees to ensure that justification is in the case files to survey tax returns with a tax avoidance transaction issue;

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<sup>29</sup> TIGTA, Ref. No. 2011-30-039, *Challenges Remain to Balance Revenue Officer Staffing With Attrition and Workload Demands* (May 2011).

<sup>30</sup> TIGTA, Ref. No. 2010-30-025, *Employment Tax Compliance Could Be Improved With Better Coordination and Information Sharing* (March 2010).

<sup>31</sup> The calendar year in which the tax return or document is processed by the IRS.

<sup>32</sup> A tax avoidance transaction is generally a specific tax transaction or promotion that reduces tax liability by taking a tax position that is not supported by tax law. These strategies may be organized and marketed, often through the Internet. The definition is not merely limited to activities that improperly reduce tax, but may also include transactions that conceal assets and income.

Have an independent function review the tax return for concurrence with the group manager's decision;

Ensure that tax returns with tax avoidance transaction issues (surveyed as excess inventory) can be readily identified, and examinations are completed once taxpayers are contacted; and

Develop procedures to ensure surveyed tax returns are included as part of the quality review process.

IRS management disagreed with TIGTA's two recommendations related to strengthening existing controls and developing procedures to include surveyed tax returns as part of the quality review process. TIGTA continues to believe that the breakdown in controls for the approval process indicates that tax returns surveyed without documentation may have yielded examination results.

### **Quality Taxpayer Service**

The Department of the Treasury and the IRS recognize that the delivery of effective taxpayer service has a significant impact on voluntary tax compliance. Answering taxpayers' questions to assist them to correctly prepare their returns reduces the need to send notices and correspondence when taxpayers make errors. Taxpayer service also reduces unintentional noncompliance and shrinks the need for future collection activity. The IRS continues to focus on the importance of improving service by emphasizing it as a main goal in its strategic plan. It is also seeking innovative ways to simplify or eliminate processes that unnecessarily burden taxpayers or Government resources.

### **Filing Season**

As of March 24, 2012, the IRS received more than 84 million tax returns. Of those, 74.3 million (88.4 percent) were e-filed and nearly 9.8 million (11.6 percent) were filed on paper (a decrease of 12.3 percent from this time last year). In addition, nearly 70.2 million refunds totaling approximately \$200.9 billion were issued. This Filing Season, the IRS has delivered significant updates to its core tax processing system, transitioning to a daily processing cycle for individual returns. Also, IRS processing systems are accepting all Forms 1040, *U.S. Individual Income Tax Return*, electronically through an updated e-filing capability. This capability is designed to eventually feed into a single, consolidated taxpayer account database that will support the deployment of the next generation of taxpayer service and enforcement functions.

However, some taxpayers who e-filed their tax returns early in the 2012 Filing Season experienced delays in receiving their tax refunds. The IRS indicated that it had experienced problems with its filters established to identify fraud and with the program used by the Modernized e-File system to create output files using the accepted e-file tax return data that other IRS systems need to continue with the processing of the tax return. Filters established to identify fraud initially identified taxpayers as having indicators of possible fraud, which resulted in the tax return being held for additional screening. Once the IRS identified that these filters were incorrectly identifying some taxpayers, it made adjustments to these filters correcting the problem.

The Modernized e-File programming problems resulted in delays in sending accepted e-filed tax return data to downstream processing systems. These problems delayed the processing of approximately 7.8 million tax returns. The majority of these tax returns were processed through the Modernized e-File system from February 2 through 11, 2012. The IRS indicated the delayed accepted tax returns were sent to downstream systems for processing by February 18, 2012. The problems also resulted in accepted tax return information not always being timely available for use in its customer service operations, including "Where's My Refund." The IRS indicated that these problems were addressed and processes were established to account for all tax returns accepted during the time frame the problem existed. The IRS is developing an end-to-end balancing process to track Modernized e-File system tax returns from acceptance to the posting of the tax return on the Master File.

In addition, as a result of budget constraints, the IRS expects to be able to serve fewer taxpayers at its Taxpayer Assistance Centers and answer fewer taxpayer telephone calls. The IRS anticipates it will have increased wait times, earlier cutoffs of assistance to avoid end-of-day overtime, and frequent unexpected closures of small Taxpayer Assistance Centers due to unscheduled employee absences. These centers plan to assist more than 6.1 million taxpayers in FY 2012. Between October 1, 2011, and March 31, 2012, the Taxpayer Assistance Centers served 3.2 million walk-in taxpayers, which includes 1.9 million walk-in taxpayers for the 2012 Filing Season. However, tax return preparation will only be provided on a limited number of days per week and only on a first come, first served basis. The IRS is also planning on providing only a 61 percent Level of Service on its toll-free lines. As of March 24, 2012, IRS assistors have answered 9.8 million calls and have achieved a 68 percent Level of Service and a 950 second (16 minutes) Average Speed of Answer. In addition, during visits to Volunteer Program sites as of March 30, 2012, TIGTA has had 29 tax returns prepared with a 48 percent accuracy rate. This is lower than the 60 percent accuracy rate TIGTA reported during the same time period for the 2011 Filing Season.

Finally, as of March 24, 2012, the IRS has identified tax returns with \$4.4 billion claimed in fraudulent refunds and prevented the issuance of \$4.3 billion (97 percent) of

the fraudulent refunds. This represents a 35 percent increase in the number of tax returns identified as of the same period last processing year.

### **Prisoner Fraud Oversight**

In TIGTA's review of the IRS's processes to identify potentially fraudulent tax returns for screening, TIGTA auditors found that the majority of tax returns the IRS identified as being filed by prisoners were not screened to assess fraud potential. TIGTA determined that 253,929 (88 percent) of the 287,918 tax returns filed by a prisoner as of March 24, 2010, were not selected for screening. Of those tax returns not screened, 48,887 individuals had no wage information reported to the IRS by employers. These 48,887 prisoners claimed refunds totaling more than \$130 million, including EITC claims of \$78.5 million. Some of these refunds may have been stopped by other compliance activities. For example, TIGTA determined that the IRS prevented the issuance of nearly \$18.1 million in EITC claims for 4,532 of the 48,887 prisoner tax returns.<sup>33</sup> In addition, the IRS is making some improvement in identifying prisoner tax returns. As of March 24, 2012, the IRS had selected 163,005 tax returns filed by prisoners for screening. This represents a 19 percent increase in the number of prisoner tax returns identified as of the same period last processing year.

Further, TIGTA's review of the IRS's compliance with the *Inmate Tax Fraud Prevention Act of 2008*<sup>34</sup> found that, as of October 2010, the IRS had not completed required agreements to allow the IRS to disclose prisoner tax return information to prison officials. As a result, no information has been disclosed to either the Federal Bureau of Prisons or State Departments of Corrections. TIGTA also found that the Calendar Year 2009 Report to Congress on prisoner fraud is incomplete. The report stated that the IRS identified 44,944 fraudulent prisoner tax returns during Calendar Year 2009. However, the processes the IRS uses to identify prisoner tax returns cause the IRS to understate the amount of prisoner fraud. Our review of the process used by the Criminal Investigation Division to compile the 2009 prisoner data file identified a lack of managerial oversight to ensure the accuracy and reliability of this file.

TIGTA recommended that the IRS work with the Department of the Treasury to seek legislation to extend the period of time the IRS has to disclose prisoner tax return data to the Federal Bureau of Prisons and State Departments of Corrections. TIGTA has also made a number of other recommendations related to prisoner fraud, which include ensuring all tax returns filed by prisoners are processed through the Electronic Fraud Detection System and receive a prisoner indicator, revising prisoner filters to

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<sup>33</sup> TIGTA, Ref. No. 2010-40-129, *Expanded Access to Wage and Withholding Information Can Improve Identification of Fraudulent Tax Returns* (September 2010).

<sup>34</sup> Pub. L. No. 110-428, 122 Stat. 4839, (codified as amended at 26 U.S.C. Section 6103(k)(10)).

validate wages and withholding associated with prisoners incarcerated for the year in which the tax return is filed claiming a refund, and developing a process to assess the reliability of data received from Federal and State prisons. The IRS partially agreed to our recommendations, but work remains before the IRS is fully in control of this issue.<sup>35</sup>

## **Identity Theft**

Since I last testified on this topic in November 2011, TIGTA has continued to assess the IRS's efforts to identify and prevent identity theft. Unscrupulous individuals are stealing identities at an alarming rate for use in submitting tax returns with false income and withholding documents to the IRS for the sole purpose of receiving a fraudulent tax refund. For Processing Year 2011, the IRS reported that it had detected approximately 940,000 tax returns involving identity theft and prevented the issuance of fraudulent tax refunds totaling \$6.5 billion. While the amount of fraudulent tax refunds the IRS detects and prevents is substantial, the IRS does not know how many identity thieves are filing fictitious tax returns and how much revenue is being lost resulting from the issuance of fraudulent tax refunds.

Fraudulent tax returns are identified through the IRS's Electronic Fraud Detection System (EFDS) as well as through the manual screening of paper tax returns. Individual tax returns are sent through the EFDS and are scored based on the characteristics of the tax return and other data. The higher the score, the greater the probability that the tax return is fraudulent. For those tax returns meeting a certain score, the tax return is sent to an IRS employee to be screened for fraud potential. For the 2012 Filing Season, the IRS has developed new filters to better identify identity theft before issuing fraudulent tax refunds. As of March 7, 2012, the IRS had identified 128,242 tax returns involving identity theft with \$793 million in associated fraudulent tax refunds.

As part of our assessment, we are identifying and quantifying potential tax refund losses resulting from identity theft. Using characteristics of IRS-confirmed fraudulent tax return filings involving identity theft, TIGTA analyzed tax returns filed during the 2011 Filing Season to identify additional tax returns that met the characteristics of these confirmed cases. We have found that the issuance of fraudulent tax refunds based on false income documents is significantly greater than the amount detected and prevented by the IRS.

Access to third-party income and withholding information at the time tax returns are processed is the single most important tool the IRS could have to identify and

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<sup>35</sup> TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (December 2010).

prevent tax fraud. This information will prevent the issuance of billions of dollars in fraudulent tax refunds. To further improve IRS's ability to identify tax returns with false income documents before refunds are paid, legislation is needed to expand IRS access to the National Directory of New Hires<sup>36</sup> wage information for tax administration purposes for the purpose of identifying tax refund fraud. Currently, its use is limited by law to just those tax returns with a claim for the EITC. The IRS included a request for expanded access to the National Directory of New Hires in its annual budget submissions for FYs 2010, 2011 and 2012. The request was made as part of the IRS's efforts to strengthen tax administration. However, the expanded access has not been provided for in the law. The IRS has again included a request for expanded access to the National Directory of New Hires as part of its FY 2013 budget submission. The ability to use this information along with third-party income and withholding information that the IRS maintains for the prior year's tax filings would help the IRS to stop identity theft related tax fraud.

Next month TIGTA will also report on the IRS's assistance to victims of identity theft. Of continuing concern is the length of time taxpayers must work with the IRS to resolve identity theft cases. It can take the IRS more than a year to resolve these cases. The IRS does not provide taxpayers with realistic time frames for how long it will take to resolve their cases. Communications between identity theft victims and the IRS are limited and confusing, and victims are asked multiple times to substantiate their identity. Taxpayers do not speak directly with the assistors who are working their identity theft cases.

The IRS has continued to take actions to improve its Identity Theft Program. As a result of an assessment of its Identity Theft Program completed in October 2011, the IRS is currently planning improvements to the program. The IRS is reorganizing to have an Identity Theft Program Specialized Group within each of the business units and/or functions where dedicated employees work the identity theft portion of the case. It will also begin collecting IRS-wide identity theft data to assist in tracking and reporting the affect identity theft has on tax administration. Nevertheless, the improvements may not be sufficient to significantly reduce the burden identity theft has placed on tax administration and on taxpayers whose identities have been stolen.

Identity theft cases have not been prioritized during the standard tax return filing process. The IRS plans to update tax return processing procedures to include a special processing code to recognize the presence of identity theft documentation on a paper-filed tax return. This will allow certain identity theft victim's tax returns identified during processing to be forwarded and assigned to an assistor, rather than continuing

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<sup>36</sup> A Department of Health and Human Services national database of wage and employment information submitted by Federal agencies and State workforce agencies.

through the standard duplicate tax return procedures. This will reduce the time a taxpayer must wait to have his or her identity theft case resolved from three to five months. However, the IRS does not plan to put this change into place until June 2012.

Additionally, if controls the IRS plans to implement do not decrease the incidence of identity theft and fraudulent returns filed by identity thieves continue to prevent lawful taxpayers from filing their tax returns, this inventory could remain at a high level. Resources have not been sufficient to work identity theft cases dealing with refund fraud and IRS employees who work the majority of identity theft cases are also telephone assistors who are trained to communicate with taxpayers and to know the tax laws and related IRS operational procedures. Identity theft cases can be complex and can present considerable challenges throughout the resolution process. The assistors are not examiners and are not trained to conduct examinations, which require skills and tools beyond those of the assistors.

The IRS uses little of the data from the identity theft cases to identify any commonalities, trends, etc., that could be used to detect or prevent future refund fraud. After resolving an identity theft case involving a duplicate tax return, the information from the identity thief's tax return is deleted from the legitimate taxpayer's account and moved to a temporary account. A special account is created for the identity thief using a temporary IRS Number (IRSN). However, the account is not flagged as an identity theft account. Therefore the IRS is unable to determine which accounts were created because of identity theft.

The ability to identify certain IRSN accounts as identity theft accounts would allow the IRS to use the information from the tax return to identify refunds improperly paid, and patterns and trends among perpetrators of identity theft. This would assist the IRS in establishing accurate data with respect to revenue lost due to identity theft, and to better understand the characteristics of potential identity theft cases. This information would aid in development of other treatments and approaches to identity theft tax fraud.

### **Criminal Investigations of Identity Theft**

When the crime of identity theft occurs within our jurisdiction, TIGTA's Office of Investigations (OI) investigates it as it impacts the economy, efficiency, and effectiveness in the administration of the Internal Revenue Code. Identity theft directly and destructively impacts law-abiding citizens. One identity theft scheme that has attracted media coverage involves individuals stealing identities and then filing fraudulent tax returns before the legitimate taxpayer files his or her own return. This results in the refunds being issued to the criminals. This crime is simple tax fraud and it falls within the jurisdiction and programmatic responsibility of the IRS. However, there

are other variations of IRS-related identity theft that, although not widely covered by the media, falls within TIGTA's jurisdiction and has a significant impact on taxpayers.

TIGTA focuses its limited investigative resources on the following areas as it pertains to IRS related identity theft:

IRS employees who are involved in committing identity theft either as the source of the identity information or through active participation in the scheme;

Tax preparers who improperly steal and disclose client information for the purpose to commit identity theft (excluding tax preparers who prepare and file fraudulent tax returns for the purpose of personally stealing the refund); and

Individuals who impersonate the IRS in furtherance of committing identity theft.

TIGTA has conducted investigations of IRS employees who utilize their access to taxpayer information as a means for stealing identities for the purpose of committing identity theft. Noted below is an example of identity theft by an IRS employee.

**Example 1:** On April 14, 2011, Monica Hernandez, a part-time data entry clerk for the IRS, was indicted for making a false income tax return. During the course of her employment with the IRS, Hernandez stole and/or misappropriated information of other taxpayers listed on various IRS forms. Hernandez used falsified and forged IRS forms to obtain large tax refunds from the IRS totaling \$175,144.

IRS employees are entrusted with the sensitive personal and financial information of taxpayers. Using this information to perpetrate a criminal scheme for personal gain negatively impacts our Nation's voluntary tax system and generates widespread distrust of the IRS. TIGTA OI pursues identity theft violations and conducts criminal investigations of IRS employees involved in these crimes.

Tax preparers who improperly steal and disclose any taxpayer's Federal tax information as part of an identity theft scheme cause serious harm to taxpayers. The following case highlights an instance when a tax preparer stole and improperly disclosed the identity of her clients in order to commit identity theft.

**Example 2:** Kathleen Lance was a public accountant and president of her company. In this capacity, Lance obtained and used the identification of six of her clients to change the direct deposit account information on clients' tax returns before she electronically submitted their returns to the IRS. Lance thereby diverted funds from the clients' banks and redirected the deposits to her personal and business bank accounts. Lance also

assumed and disclosed the identity of the six clients and fraudulently opened credit card accounts in her name. On May 24, 2010, she was sentenced to serve 64-months imprisonment and three years' probation for wire fraud, theft of Government funds, use of unauthorized access devices, and aggravated identity theft.

Impersonation of the IRS as part of an identity theft scheme has many forms. Often, the IRS is impersonated by individuals who seek to trick unsuspecting taxpayers into revealing their personal information. The details of each scheme tend to vary, but the common thread is the use of the IRS name to lure recipients into accessing links or providing sensitive information.

Victims are told that they are either due a refund or that a tax payment was rejected and the taxpayer needs to click on a link which either opens an attached form or takes them to a website where they enter their Personally Identifiable Information (PII), Federal tax information, and credit card information; or

Victims are told that they are being investigated by the IRS and need to immediately respond by clicking on a link which opens an attached form or takes them to a website, where they are prompted to provide their PII to verify the status of their tax matter.

In both of these situations, the victim is presented with a website which is designed to replicate a legitimate IRS.gov website, often by utilizing authentic IRS images and seals. The case below is an example wherein an individual impersonated the IRS to commit identity theft.

**Example 3:** Godspower Egbufor, together with co-conspirators, operated a scheme and stole the identities of numerous individuals and defrauded them out of more than \$1 million through Internet solicitations. Egbufor obtained massive e-mail distribution lists containing thousands of e-mail addresses and sent unsolicited e-mails falsely informing targeted victims that they had won a lottery or had inherited money from a distant relative. E-mails to victims falsely indicated that a Government or quasi-governmental agency, such as the IRS or the United Nations, prevented the money due to them from being awarded because advance payment of taxes and other fees were required. Follow-up e-mails instructed the victims to provide their personal and bank account information in order to receive their lottery winnings or inheritance. On December 19, 2011, Egbufor was sentenced to 108 months of imprisonment and five years of supervised release for violations of Aggravated Identity Theft and Conspiracy to Commit Wire Fraud.

In conclusion, the IRS's current strategy for reducing the Tax Gap, which is largely dependent on funding for additional compliance resources and legislative changes, is not enough. The IRS recognizes that to make meaningful improvement in voluntary compliance and to reduce the Tax Gap, it will require a long-term, focused effort encompassing taxpayer service, modernization, and enforcement, accompanied by broader simplification and reform of the tax code and significant advances in compliance technology. One of the primary challenges facing the IRS is improving research to better understand the current sources of noncompliance and to determine what actions are most effective in addressing taxpayer noncompliance.

We at TIGTA take our mandate to provide independent oversight of the IRS seriously, and we continually strive to identify ways to improve the effectiveness and efficiency of the Nation's tax system and to prevent and detect fraud, waste, and abuse. I hope my discussion of the IRS's efforts to ensure taxpayers comply with their tax obligations as well as what the IRS is doing to address the growing risk of refund-related identity theft assists you with ensuring accountability over the IRS.

Chairman Platts, Ranking Member Towns, and Members of the Subcommittee, thank you for the opportunity to share my views.



**J. Russell George**  
**Treasury Inspector General for Tax Administration**

Following his nomination by President George W. Bush, the United States Senate confirmed J. Russell George in November 2004, as the Treasury Inspector General for Tax Administration. Prior to assuming this role, Mr. George served as the Inspector General of the Corporation for National and Community Service, having been nominated to that position by President Bush and confirmed by the Senate in 2002.

A native of New York City, where he attended public schools, including Brooklyn Technical High School, Mr. George received his Bachelor of Arts degree from Howard University in Washington, DC, and his Doctorate of Jurisprudence from Harvard University's School of Law in Cambridge, MA. After receiving his law degree, he returned to New York and served as a prosecutor in the Queens County District Attorney's Office.

Following his work as a prosecutor, Mr. George joined the Counsel's Office in the White House Office of Management and Budget where he was Assistant General Counsel. In that capacity, he provided legal guidance on issues concerning presidential and executive branch authority. He was next invited to join the White House Staff as the Associate Director for Policy in the Office of National Service. It was there that he implemented the legislation establishing the Commission for National and Community Service, the precursor to the Corporation for National and Community Service. He then returned to New York and practiced law at Kramer, Levin, Naftalis, Nessen, Kamin & Frankel.

In 1995, Mr. George returned to Washington and joined the staff of the Committee on Government Reform and Oversight and served as the Staff Director and Chief Counsel of the Government Management, Information and Technology subcommittee (later renamed the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations), chaired by Representative Stephen Horn. There he directed a staff that conducted over 200 hearings on legislative and oversight issues pertaining to Federal Government management practices, including procurement policies, the disposition of government-controlled information, the performance of chief financial officers and inspectors general, and the Government's use of technology. He continued in that position until his appointment by President Bush in 2002.