

**HEARING BEFORE THE
SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT
COMMITTEE ON APPROPRIATIONS
U.S. SENATE**



May 9, 2007

Washington, DC

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

STATEMENT OF
THE HONORABLE J. RUSSELL GEORGE
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
before the
SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT
COMMITTEE ON APPROPRIATIONS
U.S. SENATE

“Internal Revenue Service FY 2008 Budget Request”

May 9, 2007

Chairman Durbin, Ranking Member Brownback, and Members of the Subcommittee, I thank you for the opportunity to testify today. My comments will focus on the Internal Revenue Service’s (IRS or Service) Fiscal Year (FY) 2008 budget, the 2007 Filing Season, and, at your request, the Treasury Inspector General for Tax Administration’s (TIGTA) FY 2008 budget request. The IRS administers America’s tax laws and collects approximately 95 percent of the revenues that fund the Federal Government. It is therefore important to identify the resources required to support the IRS’ role as steward of the Nation’s tax administration system.

Overview of the IRS’ Fiscal Year 2008 Budget Request

The major component of the Department of the Treasury, IRS has primary responsibility for administering the Federal tax system. Since this is a self-assessment system, almost everything the Service does is in some way related to fostering voluntary compliance with tax laws. It provides taxpayer service programs that help millions of taxpayers to understand and meet their tax obligations. The IRS’ resources also provide for enforcement programs aimed at deterring taxpayers who are inclined to evade their responsibilities, and vigorously pursuing those who violate tax laws.

The IRS must strive to enforce the tax laws fairly and efficiently while balancing service and education to promote voluntary compliance and reduce taxpayer burden. To accomplish these efforts, the proposed FY 2008 IRS budget requests resources of approximately \$11.4 billion. Included in this amount are approximately \$11.1 billion in direct appropriations, \$133.5 million from reimbursable programs, and \$180 million from user fees. The direct appropriation is approximately a \$657 million increase, or 6.3 percent, over the budget provided by the FY 2007 Continuing Resolution. Highlights of the increase include:

- \$131 million for taxpayer service initiatives;
- \$440 million for enforcement initiatives;

- \$282 million for the IRS' Business Systems Modernization program; and
- \$60 million for critical Information Technology (IT) infrastructure upgrades (included in the enforcement and taxpayer service totals above).

The FY 2008 budget also includes funding to implement the Department of the Treasury's (Department) tax gap strategy. In September 2006, the Department published a comprehensive plan to improve tax compliance. Additionally, delivery of IRS programs demands a secure and modernized infrastructure capable of fairly, effectively, and efficiently collecting taxes while minimizing taxpayer burden. The FY 2008 budget request supports the Service's five-year strategic plan and the Department's compliance improvement strategy. The IRS' strategic plan goals are to improve taxpayer service, enhance enforcement of the tax law, and modernize the Service through its people, processes and technology.

Improve Taxpayer Service

The FY 2008 budget increases funding for taxpayer service by \$131 million. This includes \$56 million for new service initiatives and \$75 million for cost increases. IRS employees represent the face of the Federal Government to more American citizens than most other government agencies. The request includes \$20 million to enhance taxpayer service through expanded volunteer income tax assistance, increased funding for research, and implementing new technology to improve taxpayer service.

TIGTA is concerned about the taxpayer service initiative to expand the IRS' volunteer return preparation. The IRS is requesting an additional \$5 million and 46 Full Time Equivalents (FTE)¹ to expand the VITA Program. According to the IRS, this will help "expand the IRS' volunteer return preparation, outreach and education, and asset building services to low-income, elderly, limited English proficient, and disabled taxpayers."²

TIGTA believes the IRS should proceed cautiously in its expansion efforts, given the importance of the accuracy of tax return preparation. TIGTA is reviewing the IRS' Volunteer Income Tax Assistance (VITA) program as part of our 2007 Filing Season oversight activities. As of April 12, 2007, TIGTA has had 39 tax returns prepared with a 56 percent accuracy rate. While the 2007 Filing Season accuracy rate is an improvement compared to the 39 percent accuracy rate reported for the 2006 Filing Season, taxpayers still have just a 1 in 2 chance of having their tax returns accurately prepared by VITA program volunteers.³ TIGTA's observations are that volunteers did not always use the tools and information available to them when preparing returns. There is the potential

¹ A measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For FY 2005, 1 FTE was equal to 2,088 hours.

² *U.S. Department of the Treasury FY 2008 Budget in Brief*, February 5, 2007, page 62.

³ The population of VITA sites is not fixed, and VITA sites open and close throughout the filing season. Therefore, TIGTA could not determine a total population of VITA sites and could not select a statistical sample from which to project results. The filing season is the period from January through mid-April when most individual income tax returns are filed.

that these resources might be put to better use by funding IRS assistance programs that achieve better results.

The FY 2008 IRS budget request also includes \$10 million to implement the Taxpayer Assistance Blueprint (TAB). The TAB initiative provides additional resources for new research on the needs of taxpayers in order to better understand the role of taxpayer service on compliance. The research will focus on meeting taxpayer needs by providing the right channel of communication; providing a better understanding of taxpayer burden; understanding taxpayer needs through the errors they make; and evaluating the impact of service on overall levels of voluntary compliance.

In July 2005, Congress issued a conference report requesting that the IRS develop a five-year plan for taxpayer service activities.⁴ In November 2005, the IRS was asked to provide the report to the House and Senate by April 14, 2006.⁵ The Senate committee report stated that the plan should outline the services the IRS should provide to improve service to taxpayers; detail how the IRS plans to meet the service needs on a geographic basis; and, address how the IRS would improve taxpayer service based on reliable data. The plan was to be developed with the IRS Oversight Board⁶ and the National Taxpayer Advocate.

The IRS conducted a comprehensive review of its current portfolio of services to individual taxpayers to determine which services should be provided and improved. Based on the findings of the TAB review, the funding for this initiative would implement telephone service and Web site enhancements.

To satisfy the report submission date of April 14, 2006, the IRS designed the TAB as a two-phased process. The TAB Phase I report identified strategic improvement themes by researching IRS service relative to taxpayers' needs and preferences. The TAB Phase II report will validate those themes through further research of taxpayers' service preferences and will develop the five-year plan for service delivery. The 2006 TAB Phase I report, issued April 24, 2006, presented strategic themes to improve education and awareness; optimize partner services; elevate self-service options; improve and expand training and services; and, develop performance and outcome goals and metrics.

⁴ United States Congress, Senate Report 109-109. *Transportation, Treasury, The Judiciary, Housing and Urban Development, and Related Agencies Appropriations Bill, 2006: Internal Revenue Service, Processing, Assistance and Management, Committee Recommendation*, July 26, 2005.

⁵ United States Congress, Conference Report 109-307. *Joint Explanatory Statement of the Committee of Conference: Internal Revenue Service, Processing Assistance, and Management (Including Rescission of Funds)*, November 14, 2005.

⁶ A nine-member independent body charged with overseeing the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws and to provide experience, independence, and stability to the IRS so that it may move forward in a cogent, focused direction.

The focus of the TAB initiative is on services that support the needs of individual filers who file or should file Form 1040 series tax returns.⁷ TIGTA reviewed the development of the TAB, and found that while the majority of the information it contains is accurate, some of the information is not accurate. The compilation of some of the data could adversely affect IRS management decisions. For example, TIGTA noted inaccuracies in the report related to changes in Taxpayer Assistance Center visits and the number of telephone calls answered. Overall, TIGTA concluded that information found to be inaccurate and inconsistent did not affect the IRS' strategic improvement themes.⁸

The inaccuracies and inconsistencies resulted primarily from the IRS not having an effective process to ensure that all statements in the TAB Phase I report correctly reflected the results of its research and data analyses. According to IRS officials, actions were taken to improve the process for the validation of information included in the TAB Phase II report. The actions included an in-depth review to locate and verify the accuracy of all data in the report. Verifications were also performed to ensure the accuracy of statements and representations included in the report. Based on these actions, TIGTA did not make recommendations on the TAB Phase I report.

If these inconsistencies exist in the Phase II report, the risk increases that the IRS will draw inaccurate conclusions based on erroneous data.⁹ TIGTA was unable to determine the impact the inconsistencies may have on results outlined in the TAB Phase II report because it was not available for review. The IRS did not provide TIGTA with a copy of the report before it was officially issued.

2007 Filing Season

The 2007 Filing Season appears to be progressing without major problems. As of April 28, 2007, the IRS reported that it had received more than 125 million individual tax returns. Of those returns, more than 76 million (61 percent) were filed electronically. The number of electronically filed tax returns is 8.7 percent higher than at the same time last year. The IRS has issued almost 92 million refunds for a total of \$209 billion.

While the IRS has seen a growth in the number of electronically filed tax returns so far this filing season, the number of Free File returns is down slightly. As of April 28, 2007, the IRS received approximately 3.7 million tax returns through the Free File Program, compared to approximately 3.8 million returns at the same time last year.

⁷ Form 1040 series tax returns include any IRS tax forms that begin with "1040" such as U.S. Individual Income Tax Return (Form 1040), U.S. Individual Income Tax Return (Form 1040-A), and Income Tax Return for Single and Joint Filers With No Dependents (Form 1040-EZ).

⁸ Draft Audit Report - *The Strategic Improvement Themes in the Taxpayer Assistance Blueprint Phase I Report Appear to Be Sound; However, There Were Some Inaccurate Data in the Report* (TIGTA Audit Number 200740012, dated April 13, 2007).

⁹ The TAB Phase II report was issued the week of April 9, 2007, after completion of TIGTA's TAB Phase I review. TIGTA has begun a review and evaluation of the TAB Phase II report and will include testing of the quality review process.

Over the past few years, TIGTA audits have shown that the IRS has improved customer assistance in its face-to-face, toll-free telephone, tax-return processing, and electronic services, including the IRS public Internet site (www.IRS.gov).¹⁰

Use of IRS.gov is up with over 133 million visits to the Web site, while the Taxpayer Assistance Centers (TACs) have received 2.2 million walk-in contacts, approximately 3 percent more than this time last year. TIGTA made anonymous visits to TACs to determine if taxpayers are receiving quality service, including correct answers to their questions. The assistor level of service in the IRS' toll-free operations was higher than was planned, as the IRS answered 14.6 million calls. The IRS also completed 17.5 million automated calls; a decrease of 5.4 percent from last year's 18.5 million.

Telephone Excise Tax Refunds

A concern so far this filing season has been the IRS' telephone excise tax refund program. The IRS estimated that between 151 million and 189 million people would seek this one-time refund, including many without a filing requirement. Taxpayers may claim either a standard refund amount or an itemized refund for the actual excise tax they paid on their telephone bills. By using the standard amounts individuals do not have to assemble 41 months of telephone bills to determine the amount of their refund. Requesting one of the standard amounts requires the completion of only one additional line on the tax return.

The standard amounts developed by the IRS have proved to be very effective. Through the week ending April 21, 2007, IRS records indicate that 99.5 percent of telephone excise tax refund claims were filed for standard amounts. However, over 28.5 percent of the total number of individual tax returns filed contained no claim for a telephone excise tax refund, which indicates that many taxpayers may not be aware of their opportunity to claim this refund. TIGTA is continuing to monitor the steps the IRS is taking to address this issue.¹¹

TIGTA raised concerns to the IRS regarding the processing of returns claiming telephone excise tax refunds for non-standard amounts. Specifically, thresholds were set too high for the IRS to take action when taxpayers:

- claimed refunds for more than the standard amounts but did not provide the required Form 8913, Credit for Federal Telephone Excise Tax Paid, to substantiate their claims.
- claimed one amount on their tax return and a different amount on their Form 8913.

When TIGTA reported these issues, the IRS took immediate steps to address the problems.

TIGTA has also raised concerns with the IRS' implementation of its compliance strategy related to these claims. In TIGTA's opinion, the dollar threshold used to identify potentially egregious claims is set too high. As of April 28, 2007, over 51,000 such

¹⁰ *Taxpayer Service Is Improving, but Challenges Continue in Meeting Expectations* (TIGTA Reference Number 2006-40-052, dated February 2006).

¹¹ Ongoing Audit - *Telephone Excise Tax Refund* (TIGTA Audit Number 200630036).

claims had been received that did not meet the IRS' criteria for review. The amount of telephone excise tax refunds on these claims totaled more than \$44.1 million. Over 38,000 of these claims were on tax returns with no Schedules C, E or F,¹² which makes the claimed amounts even more questionable. If each of the 38,000 returns claimed the standard excise tax refund amount of \$60, the total refunds would equal \$2.3 million. While small business claims for actual excise taxes paid would likely be greater than the standard amount, the lack of corresponding Schedules C, E or F raises questions about the claims.

The IRS reported that it set the threshold high because its examination resources are limited, and because it believes that examinations of returns claiming the Earned Income Credit (EITC)¹³ and other discretionary examinations will result in higher assessment rates than examinations of the telephone excise tax refund claims. TIGTA recommended that the IRS re-examine all options at its disposal to address significantly more inappropriate telephone excise tax refund claims. The IRS responded to TIGTA's concerns, stating that it did not plan to make adjustments to the threshold amounts.

TIGTA has also shared concerns about paid preparers and the telephone excise tax refund with the IRS. As of April 28, 2007, one paid preparer had filed over 1,500 returns with telephone excise tax refund claims exceeding the standard amounts. Only eight of this preparer's claims have exceeded the Service's tolerance. TIGTA referred this preparer to the IRS' Criminal Investigation function. The IRS requested information from TIGTA regarding other questionable preparers who may be avoiding IRS scrutiny. TIGTA provided the requested information to the Service on other preparers. Among them:

- One preparer has filed 1,019 claims totaling over \$677,000. The claims are all under IRS' tolerance, and most of the claims are for one of five amounts that are repeated on the filed claims.
- Another preparer has filed 1,138 claims. The preparer has filed returns for taxpayers in 31 different States. In addition to telephone excise tax refund claims, over 95 percent of the returns also claim employee business expenses.

Enhance Enforcement of the Tax Laws

The FY 2008 budget request is designed to continue the IRS' emphasis on tax enforcement. The request increases funding for enforcement by approximately \$440 million, which includes \$291 million for new enforcement initiatives and \$149 million in cost increases. The increase includes funding for additional enforcement personnel. According to the request, increased resources for the IRS' examination and collection programs will yield direct measurable results each year of \$699 million.

¹² Various schedules may be attached to a tax return, if needed. Schedule C is for reporting Profit or Loss From Business; Schedule E is for Supplemental Income and Loss; and Schedule F is for Profit or Loss From Farming.

¹³ The Earned Income Tax Credit (EITC) is a refundable credit designed to help move low-income taxpayers above the poverty level.

Included in the IRS' FY 2008 budget request is an initiative to improve compliance estimates and measures, and also improve detection of non-compliance. This enforcement initiative would fund research studies of compliance data for new segments of taxpayers needed to update existing estimates of reporting compliance. Unlike the past, the IRS plans to conduct an annual study of compliance among Form 1040 filers based on a smaller sample size than the 2001 National Research Program study.

TIGTA reviewed the tax gap estimates that were developed from the 2001 National Research Program data and concluded that the IRS still does not have sufficient information to completely and accurately assess the overall tax gap and voluntary compliance rate. Although having new information about Tax Year (TY) 2001 individual taxpayers is an improvement when compared to the much older TY 1988 information from the last major compliance study, some important individual compliance information remains unknown. Additionally, although individuals comprise the largest segment of taxpayers and were justifiably studied first, no new information is available about employment, small corporate, large corporate and other compliance segments. With no firm plans for further studies or updates in many areas of the tax gap, the current tax gap estimate is an unfinished picture of the overall tax gap and compliance rate.

The IRS' FY 2008 budget request also includes funding for an initiative to improve compliance among small business and self-employed taxpayers in the areas of reporting, filing, and payment by increasing audits of high-risk tax returns, collecting unpaid taxes, and investigating and, where appropriate, prosecuting persons who have evaded taxes. According to the budget request, this initiative would produce \$144 million in additional annual enforcement revenue, once newly hired employees reach their full performance potential in FY 2010.

Modernize the IRS through Its People, Processes and Technology

The IRS must optimally manage its resources, business processes, and technology systems to effectively and efficiently support its service and enforcement mission. The IRS' FY 2008 budget request includes initiatives to update critical information technology infrastructure (\$60 million), and to enhance the IRS' Computer Security Incident Response Center (CSIRC) and its network infrastructure security (\$21 million).

Upgrading the Service's critical IT infrastructure initiative would include upgrading equipment that has exceeded its life cycle. According to the budget request, failure to replace the IRS' IT infrastructure will lead to increased maintenance costs and increase the risk of disrupting business operations. Planned expenditures in FY 2008 include replacing desktop computers, automated call distributor hardware, mission critical servers, and Wide Area Network/Local Area Network routers and switches.

Enhancing the CSIRC would require \$13.1 million to allow the CSIRC to keep pace with the ever-changing security threat environment through improved detection and analysis capability, improved forensics, and increased capacity to identify and respond to potential intrusions before they occur. An additional \$7.9 million would fund

enhancements to the IRS' network infrastructure security, providing the capability to perform continuous monitoring of the security of operational systems, using security tools, tactics, techniques, and procedures to perform network security compliance monitoring of all IT assets on the network.

Less than two months ago, TIGTA reported that IRS employees reported the loss or theft of at least 490 computers and other sensitive data in 387 separate incidents. Employees reported 296 (76 percent) of the incidents to the TIGTA Office of Investigations but not to the CSIRC. In addition, employees reported 91 of the incidents to the CSIRC; however, 49 of these were not reported to TIGTA's Office of Investigations. IRS procedures require employees to report lost or stolen computers to both the IRS CSIRC and to TIGTA's Office of Investigations. TIGTA reported that coordination was inadequate between the CSIRC and TIGTA's Office of Investigations to identify the full scope of the losses.¹⁴

Prior to the Department of Veterans Affairs data loss incident in May 2006, the CSIRC had not placed sufficient emphasis on identifying actual taxpayers potentially affected by lost or stolen computers. TIGTA's Office of Investigations did investigate many of these incidents but focused on criminal aspects (e.g., identifying the perpetrator and recovering the stolen equipment).

On July 7, 2006, the Chief, Mission Assurance and Security Services, issued a memorandum that re-emphasized reporting requirements and stated that all computer security incidents shall be reported to the CSIRC and to front-line managers. In addition, any incident involving physical loss of equipment that could result in unauthorized access to IRS systems or information must also be reported to the TIGTA Office of Investigations. The IRS Commissioner had issued an earlier email reminding all managers to safeguard personally identifiable information and to immediately report any security incidents to the CSIRC. The email message also stated that managers work with the CSIRC to promptly notify the TIGTA Office of Investigations when appropriate. As a final measure to ensure total coordination, the IRS has entered into an agreement with the TIGTA Office of Investigations to share reports of all incidents relating to the loss or theft of IT assets.

The Service's FY 2008 budget request includes an initiative to fund Business Systems Modernization. The initiative would provide approximately \$62.1 million to continue the development and deployment of the IRS' modernization program in line with the recommendations identified in the IRS' Modernization, Vision, and Strategy. According to the request, the increase would allow the IRS to continue progress on modernized projects, such as the Customer Account Data Engine (CADE) and Modernized e-File (MeF).

CADE is the IRS' lynchpin modernization project that will replace the antiquated master file system, which is based on a 1960s architecture. The IRS is developing CADE

¹⁴ *The Internal Revenue Service Is Not Adequately Protecting Taxpayer Data on Laptop Computers and Other Portable Electronic Media Devices* (TIGTA Reference Number 2007-20-048, March 23, 2007).

in stages and expects to retire the Individual Master File in 2012. When fully operational, the CADE database will house tax information for more than 200 million individual and business taxpayers. Congress authorized \$58 million for the CADE in FY 2007. Through FY 2007, CADE project release costs total about \$233.9 million. The IRS initiated the CADE project in September 1999 and began delivering releases in August 2004.

During Calendar Year (CY) 2006, the CADE posted over 7.3 million tax returns and generated more than \$3.4 billion in refunds. This is a significant increase over the 1.4 million tax returns posted in CY 2005 that generated refunds totaling more than \$427 million. The CADE is now in the process of completing delivery of Release 2.2. Release 2.2 will process 2007 Filing Season tax law revisions (Tax Year 2006) and additional tax forms.¹⁵

On February 27, 2007, the IRS put Release 2.2 into production, but because computer reports on the number of returns received did not match the number of returns posted, the CADE was turned off and tax returns were sent back to the current IRS processing system. The IRS reports that a major portion of Release 2.2 was successfully put into production on March 6, 2007 (seven weeks late). On the first day, it posted over 571,000 tax returns of which 566,332 contained refunds. Because of the late start into production, the IRS goal of using the CADE to process 33 million tax returns will not be met. According to IRS officials, the latest estimate was that the IRS would complete the deployment of Release 2.2 by the end of April 2007, and it would post between 16 million and 19 million returns during the 2007 Filing Season. As of April 27, 2007, the CADE has processed 10.3 million returns with \$10.9 billion in refunds.

From the project's beginning, there has been a pattern of deferring CADE requirements to later releases and missing release deployment dates. Allowing this pattern to continue will undermine the long-term success of the project. To meet the CADE's long-term computer processing demands, further consideration needs to be given to alternative design approaches. The project design currently includes building a computer system large enough to process the highest daily volume of tax returns received by the IRS even though this processing capacity is needed for only a few days each year. Alternative design solutions, such as obtaining additional computer resources on an interim basis or delaying the processing of some tax return types on extremely high-volume processing days, have been considered but have not been thoroughly developed. In addition, based on the current design of the project, meeting storage and processing demands may be cost prohibitive.

MeF is the future of electronic filing. It provides a single Extensible Markup Language-based standard for filing electronic tax returns. Standardizing the formats/structures for all filings will allow transmitters to submit multiple return types in the same transmission, something that currently restrains e-file growth. In FY 2008, the IRS has scheduled to start development and implementation of the Form 1040 on the MeF

¹⁵ DRAFT Audit Report - *Vital Decisions Must Be Made to Ensure Successful Implementation of Customer Account Data Engine Capabilities* (TIGTA Audit Number 200620012, dated May 1, 2007).

platform, which is expected to take two years. TIGTA is currently concluding an audit of the MeF and will report the results later this spring.

Legislative Proposals

The FY 2008 budget request includes several legislative proposals that would provide the IRS with additional enforcement tools to improve compliance. It is estimated that these proposals could generate approximately \$29 billion in revenue over the next 10 years. These proposals would expand information reporting, improve compliance by businesses, and expand penalties. This enforcement initiative includes funding for purchasing software and making modifications to the IRS' IT systems, which are necessary to implement these legislative proposals.

Treasury Inspector General for Tax Administration Fiscal Year 2008 Budget Request

TIGTA was created by Congress to provide independent oversight of the IRS. TIGTA's investigations and audits protect and promote the fair administration of the Nation's tax system. TIGTA's responsibilities include ensuring that the IRS is accountable for more than \$2 trillion in tax revenue received each year. TIGTA's investigations protect the integrity of IRS employees, contractors, and other tax professionals; provide for infrastructure security; and protect the Service from external attempts to threaten or corrupt the administration of tax laws. TIGTA conducts audits that advise Congress, the Secretary of the Treasury, and IRS management of high-risk issues, problems, and deficiencies related to the administration of IRS programs and operations. TIGTA's audit recommendations aim to improve IRS systems and operations, while maintaining fair and equitable treatment of taxpayers.

TIGTA's Office of Audit (OA) provides comprehensive coverage and oversight of all aspects of the Service's daily operations. Audits not only focus on the economy and efficiency of IRS functions but also ensure that taxpayers' rights are protected and the taxpaying public is adequately served. Overall, as of March 31, 2007, audit reports potentially produced financial accomplishments of \$579 million, and potentially impacted approximately 379,000 taxpayer accounts in areas such as taxpayer burden, rights, and entitlements. OA develops an annual audit plan that communicates oversight priorities to Congress, the Department of the Treasury, and the IRS. Emphasis is placed on mandatory coverage imposed by the IRS Restructuring and Reform Act of 1998¹⁶ and other statutory authorities, as well as issues impacting computer security, taxpayer rights and privacy, and financial-related audits. OA's work focuses on IRS' major management challenges, IRS' progress in achieving its strategic goals, eliminating IRS' systemic weaknesses, and the Service's response to the President's Management Agenda initiatives.

¹⁶ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

TIGTA's mission includes the statutory responsibility to protect the integrity of tax administration and to protect the ability of the IRS to collect revenue for the Federal Government. To accomplish this, TIGTA's Office of Investigations (OI) investigates allegations of criminal violations and administrative misconduct by IRS employees, protects the Service against external attempts to corrupt tax administration, and ensures IRS employee safety and IRS data and infrastructure security. Employee investigations include extortion, theft, taxpayer abuses, false statements, financial fraud, and unauthorized access (UNAX) of confidential taxpayer records by IRS employees. Investigations of external attempts to corrupt tax administration include bribes offered by taxpayers to compromise IRS employees, the use of fraudulent IRS documentation to commit crimes, taxpayer abuse by tax practitioners, impersonation of Service employees, and the corruption of IRS programs through procurement fraud. TIGTA assists in maintaining IRS employee and infrastructure security by investigating incidents of sabotage, and threats or assaults made against IRS employees, facilities, and infrastructure.

From FY 2001 to FY 2006, TIGTA's labor expenses have grown 22 percent from \$88 million to \$107.3 million, despite a substantial reduction in FTEs (a decrease of 11 percent from 938 to 838). Labor costs currently account for 81 percent of TIGTA's annual budget. Labor and rent together consume approximately 87 percent of the annual budget. The FY 2007 President's budget request for TIGTA was \$136.5 million. TIGTA's actual FY 2007 funding level was \$132.9 million, a \$3.6 million reduction (2.6 percent decrease). Total resources required in FY 2008 to support its mission are \$140.6 million.¹⁷

Since FY 2001, TIGTA has achieved its performance and quality expectations by implementing several efficiency and cost-cutting initiatives. From FY 2001 to FY 2006, discretionary spending (such as training, travel, equipment, etc.) fell nearly 21 percent from \$19.5 million to \$15.4 million. These costs currently consume only 12 percent of TIGTA's annual budget. Through incremental FTE losses and implementation of cost-cutting initiatives in non-labor expense categories, TIGTA has been able to finance annual pay and labor-related benefit increases (health care, pensions and retirement) while also maintaining the FTE level necessary to meet performance and quality expectations.

TIGTA's efficiency-enhancing and cost-cutting initiatives are largely exhausted. The impact of a budget reduction in FY 2008 will fall almost exclusively on labor and, would affect TIGTA's capability to provide comprehensive oversight of IRS operations. TIGTA has lost 100 FTEs because budget increases have not been adequate to finance annual pay increases, labor-related benefit increases, and non-labor related requirement expenses such as contracts, rent, and equipment. Because of decreasing budgets, TIGTA's overall employee population has declined 12 percent from FY 2001 to FY 2006 (a decrease from 938 in FY 2001 to 825 at end of FY 2006) and is expected to continue to decline over the foreseeable future. In addition, 39 percent of TIGTA's current staff is

¹⁷ *U.S. Department of the Treasury FY 2008 Budget in Brief*, February 5, 2007, pages 29 - 31.

retirement eligible through FY 2010, threatening TIGTA's overall ability to effectively fulfill its core missions.

Labor reductions would reduce TIGTA's enforcement capacity and circumscribe efforts to combat IRS employee misconduct and external threats to the security and integrity of IRS personnel and infrastructure. FTE losses would result in fewer opportunities to examine high-risk areas and, thus, reduce financial benefits from audit recommendations and impact fewer taxpayer accounts. Losses would also require TIGTA to curtail, delay and/or fail to initiate reviews of high-risk areas and/or eliminate entire programs.

TIGTA must also address human capital issues. In order to accomplish its mission, TIGTA employees need to possess the necessary skills. Because of the increasingly modernized and computerized IRS operating systems and environment, the most critical gaps TIGTA faces are in the Auditor and Criminal Investigator occupations.

TIGTA also faces the challenge of addressing increasing requests from Congress and other IRS stakeholders in a timely and efficient manner. In FY 2007, TIGTA has reallocated resources in order to perform congressionally requested audits and comply with new statutory provisions. TIGTA anticipates increased congressional interest and requests in future years.

The FY 2008 President's budget request for TIGTA will be used to continue to provide critical audit and investigative services, ensuring the integrity of tax administration on behalf of the Nation's taxpayers. While there are a number of critical areas in which TIGTA will provide oversight, highlights of TIGTA's investigative and audit priorities include:

- Adapting to the IRS' continuously evolving operations and mitigating intensified risks associated with modernization, outsourcing, and enforcement efforts;
- Responding to threats and attacks against IRS personnel, property, and sensitive information;
- Improving the integrity of IRS operations by detecting and deterring fraud, waste, abuse, or misconduct by IRS employees;
- Conducting comprehensive audits that include recommendations for cutting costs and enhancing IRS service to taxpayers; and
- Informing Congress and the Secretary of the Treasury of problems and the progress being made to resolve them.

Total resources needed in FY 2008 to support TIGTA's mission are \$141,753,000, including \$140,553,000 from direct appropriations and approximately \$1,200,000 from reimbursable agreements. Budget adjustments to maintain current levels in FY 2008 include \$4.87 million to fund the cost of the January 2007 pay increase, the proposed January 2008 pay raise, and non-labor related items.

I hope my discussion of some of the FY 2008 budget and 2007 Filing Season issues will assist you with your oversight of the IRS. Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to share my views.