DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20005

INSPECTOR GENERAL
FOR TAX
ADMINISTRATION

October 15, 2015

MEMORANDUM FOR SECRETARY LEW

FROM: J. Russell George
Inspector General

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2016

The Reports Consolidation Act of 2000[1] requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the annual *Department of the Treasury Agency Financial Report*, its perspective on the most serious management and performance challenges confronting the Internal Revenue Service (IRS).

Each year, TIGTA evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerabilities to the Nation's tax system. For Fiscal Year (FY) 2016, the top management and performance challenges, in order of priority, are:

1. Security for Taxpayer Data and IRS Employees;
2. Implementing the Affordable Care Act and Other Tax Law Changes;
3. Tax Compliance Initiatives;
4. Fraudulent Claims and Improper Payments;
5. Achieving Program Efficiencies and Cost Savings;
6. Improving Tax Systems and Online Services;
7. Providing Quality Taxpayer Service Operations;
8. Globalization;
9. Taxpayer Protection and Rights; and
10. Human Capital.

In FY 2014, the IRS collected nearly $3.1 trillion in tax revenue, processed more than 242 million tax returns and other forms, and issued approximately $374 billion in tax refunds. Between FYs 2010 and 2014, the IRS budget declined by $850 million to approximately $11.3 billion and the IRS lost approximately 13,000 full-time employees. In FY 2015, the IRS's budget was further reduced to $10.9 billion, a cut of approximately $346 million from the FY 2014 level and more than one billion dollars less than the 2010 level.

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[1] 31 U.S.C. § 3516(d) (2006).

TIGTA and other independent oversight bodies[2] have highlighted the serious challenges that declining budgets pose to the IRS as it tries to meet its statutory obligations and effectively administer the Nation's tax system. TIGTA has reported how this trend of lower budgets, reduced staffing, and the loss of supplementary funding for the implementation of the Patient Protection and Affordable Care Act (Affordable Care Act)[3] has affected the IRS's ability to deliver its priority program areas, including customer service and enforcement activities.[4]

In FY 2016, it appears that the IRS may once again face substantial budgetary pressure. Both the House and Senate Committees on Appropriations recommended budgets below the FY 2015 enacted level of $10.9 billion. As the IRS faces new or growing challenges with a reduced budget and smaller staff, it must attempt to identify and implement innovative and cost-saving strategies. However, with staffing costs making up approximately 75 percent of its budget, the IRS will undoubtedly be challenged to find areas of savings that will allow it to balance quality customer service, strong tax enforcement, and protection of taxpayer information.

The following information detailing the management and performance challenges is provided to promote economy, efficiency, and effectiveness in the IRS's administration of the Nation's tax laws.

SECURITY FOR TAXPAYER DATA AND IRS EMPLOYEES

Cybersecurity threats against the Federal Government continue to grow. According to the Department of Homeland Security's U.S. Computer Emergency Readiness Team, Federal agencies reported 69,851 cyberattacks in FY 2014, an increase of about 15 percent from FY 2013.[5]

The IRS relies extensively on its computer systems to support both its financial and mission-related operations. These computer systems collect and process extensive amounts of taxpayer data, which includes Personally Identifiable Information. Based on the increased number and sophistication of threats to taxpayer information and the need for the IRS to better protect taxpayer data and improve its enterprise security program, securing IRS systems and protecting the confidentiality of taxpayer information continues to be a top concern facing the IRS.

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[2] Examples include the Government Accountability Office, the IRS National Taxpayer Advocate, and the Internal Revenue Service Advisory Council.
[3] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Heath Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.
[4] TIGTA, Ref. No. 2014-10-025, *Implementation of Fiscal Year 2013 Sequestration Budget Reductions* (June 2014) and Ref. No. 2015-30-035, *Reduced Budgets and Collection Resources Have Resulted in Declines in Taxpayer Service, Case Closures, and Dollars Collected* (May 2015).
[5] Office of Management and Budget, *Annual Report to Congress: Federal Information Security Management Act* (Feb. 2015).

In May 2015, the IRS announced that criminals had used taxpayer-specific data acquired from non-IRS sources to gain unauthorized access to tax account information through the IRS's "Get Transcript"[6] application. As of August 17, 2015, the IRS indicated that unauthorized users were successful in obtaining access to information for more than 350,000 taxpayer accounts. However, the actual number of individuals whose personal information was available to criminals accessing these tax accounts is significantly larger, in that these tax accounts include information on all of the individuals claimed on a tax return (*e.g.,* spouses and dependents). According to the IRS, an individual or individuals succeeded in clearing an authentication process that required knowledge of the taxpayer's information, including Social Security information, date of birth, tax filing status, and street address. In addition, it appears that these third parties had access to private personal information that allowed them to correctly answer questions that typically only the taxpayer would know. TIGTA's Office of Investigations, in conjunction with the IRS and other Federal law enforcement partners, continues to investigate this incident.

The risk for unauthorized access to tax accounts will continue to grow as the IRS focuses its efforts on delivering self-assisted online tools to taxpayers. The IRS's vision is to provide taxpayers and tax professionals with the electronic products and services that they desire to enable them to interact and communicate with the IRS.[7] This includes expanded online services, based on the idea of accessing Government services anywhere, any time, on any device, in three to five years.

TIGTA has identified a number of areas in which the IRS could better protect taxpayer data and improve its overall security position. The IRS shares Federal tax information and other IRS records with many Federal, State, and local agencies as well as private agencies and contractors through system interconnections.

During our most recent Federal Information Security Modernization Act[8] evaluation of the IRS's information security programs and practices,[9] we found three security program areas, Continuous Monitoring Management, Identity and Access Management, and Configuration Management, that did not meet the level of performance specified by the Department of Homeland Security.[10]

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[6] Information available on the Get Transcript application can include account transactions, line-by-line tax return information, and income reported to the IRS.
[7] *Internal Revenue Service Strategic Plan – FY 2014-2017* (IRS Publication 3744) (Rev. June 2014).
[8] Pub. L. No. 113-283. This law amends chapter 35 of title 44 of the United States Code to provide for reform to Federal information security.
[9] TIGTA, Ref. No. 2015-20-092, *Treasury Inspector General for Tax Administration – Federal Information Security Modernization Act Report for Fiscal Year 2015* (Sept. 2015).
[10] To assist the Inspectors General in evaluating compliance with the Federal Information Security Modernization Act, the Department of Homeland Security issued the *Fiscal Year 2015 Inspector General Federal Information Security Modernization Act Reporting Metrics*, which specified 10 information security program areas and listed specific attributes within each area for evaluation.

Continuous Monitoring Management ensures ongoing, real-time awareness of information security, vulnerabilities, and threats to IRS systems and the environments in which those systems operate. We found that the IRS is still in the process of implementing its Information Security Continuous Monitoring program required by the Office of Management and Budget to automate asset management and maintain secure configuration of assets in real time.

Identity and Access Management ensures that only those with a business need are able to access IRS systems and data. We found that the IRS did not achieve Governmentwide goals for implementing access to systems and physical access to facilities in compliance with Homeland Security Presidential Directive-12, which requires Federal agencies to issue personal identity verification cards to employees and contractors for accessing agency systems and facilities.

Configuration Management ensures that settings on IRS systems are maintained in an organized, secure, and approved manner, including timely installing patches to resolve known security vulnerabilities. We found that the IRS has not fully implemented enterprise-wide automated processes to identify computer assets, evaluate compliance with configuration policies, and deploy security patches.

TIGTA also found that many interconnections[11] in use at the IRS do not have proper authorization or security agreements. Although the IRS has established an office to provide oversight and guidance for the development of security agreements, that office is not responsible for managing or monitoring agreements for all external interconnections in use in the IRS environment. TIGTA believes the lack of a centralized inventory and an enterprise-level approach to ensure that all external interconnections are monitored has contributed to interconnections that are currently active but lack proper approvals and assurances that the interconnections meet current security requirements.[12]

Besides safeguarding a vast amount of sensitive data, the IRS must work to protect taxpayers by educating them on the numerous schemes currently employed by criminals posing as IRS employees intent on deceiving taxpayers into providing their personal financial information or coercing them into paying money on phony tax obligations. To date, TIGTA's Office of Investigations has logged more than 676,000 contacts from taxpayers who reported that they had received telephone calls from individuals who claimed to be IRS employees. These criminal impersonators told the victims that they owed taxes that if not immediately paid would result in arrest, loss of their driver's license, or other consequences. More than 4,300 victims have reported

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[11] The National Institute of Standards and Technology defines a system interconnection as the direct connection of two or more information technology systems for the purpose of sharing data and other information resources.
[12] TIGTA, Ref. No. 2015-20-087, *Improvements Are Needed to Ensure That External Interconnections Are Identified, Authorized, and Secured* (Sept. 2015).

that they paid the criminal impersonators more than $22 million since October 2013. Scams such as these are not typically resolved quickly because of their complexity. TIGTA is diligently working to identify these criminals so they can be referred to the U.S. Department of Justice for prosecution.

IMPLEMENTING THE AFFORDABLE CARE ACT AND OTHER TAX LAW CHANGES

The Affordable Care Act represents the largest set of tax law changes in more than 20 years and presents a continuing challenge for the IRS as provisions take effect. The Affordable Care Act provisions provide incentives and tax breaks to individuals and small businesses to offset health care expenses. The provisions also impose penalties, administered through the tax code, for individuals and businesses that do not obtain health care coverage for themselves or their employees. The IRS was responsible for implementing two primary provisions of the Affordable Care Act during the 2015 Filing Season: Minimum Essential Coverage and the Shared Responsibility Payment,[13] and the Premium Tax Credit.[14]

TIGTA found that the IRS has not developed processes and procedures to ensure taxpayer compliance with the Minimum Essential Coverage and Shared Responsibility Payment requirements during the 2015 Filing Season.[15] IRS management indicated that a business decision was made to not develop processes and procedures because the receipt of required insurer and employer information reports had been delayed. The IRS plans to use information obtained during the 2015 Filing Season to develop post-processing compliance strategies to be used in future years to evaluate taxpayers' compliance with these provisions. TIGTA will continue to evaluate the IRS's efforts to verify taxpayers' compliance in this area.

The Affordable Care Act also created the refundable Premium Tax Credit to assist eligible taxpayers with paying their health insurance premiums. Individuals may elect to have the credit paid directly to their health insurance providers to cover the cost of their premiums (referred to as Advance Premium Tax Credit) or receive it as a lump sum credit on their Federal income tax return. As of January 2015, individuals who received an Advance Premium Tax Credit were required to reconcile the amount paid on their behalf to the allowable amount of their Premium Tax Credit when the Tax Year 2014 return was filed. However, the IRS did not receive the required Exchange Periodic

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[13] Minimum Essential Coverage is health insurance coverage that contains essential health benefits such as emergency services, maternity and newborn care, and preventive and wellness services. If an individual does not have Minimum Essential Coverage and does not qualify for a coverage exemption, the individual will need to make a shared responsibility payment when filing his or her Federal income tax return.

[14] A Premium Tax Credit is a refundable tax credit to assist individuals and families in purchasing health insurance coverage through an Exchange.

[15] TIGTA, Ref. No. 2015-43-030, *Affordable Care Act: Assessment of Internal Revenue Service Preparations to Ensure Compliance With Minimum Essential Coverage and Shared Responsibility Payment Requirements* (Mar. 2015).

Data[16] from all Exchanges[17] at the start of the filing season. Because of the incomplete or unreported data from the Exchanges, the IRS was unable to ensure that taxpayers claiming the Premium Tax Credit met the key eligibility requirement of purchasing insurance through an Exchange and taxpayers who received the Advance Premium Tax Credit properly reconciled the credit on their tax returns.[18]

In addition to implementing the Affordable Care Act, the IRS faces the challenge each year of implementing tax law changes from new, renewed, or expiring tax law provisions. Correctly implementing tax law changes remains a significant challenge because the legislative actions generating these changes typically occur late in the year, shortly before the filing season begins. As a result, the IRS must revise various forms, instructions, and publications, and reprogram its computer systems to ensure that tax returns are accurately processed. Errors in the IRS's tax return processing systems may delay tax refunds, affect the accuracy of taxpayer accounts, and result in incorrect taxpayer notices.

TAX COMPLIANCE INITIATIVES

The underreporting of individual and corporate income, employment, and estate taxes, at $376 billion a year, accounts for the largest portion of the $450 billion Tax Gap. The Tax Gap is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year. The IRS addresses the Tax Gap by attempting to identify questionable tax returns when they are received and processed and by conducting examinations of tax returns filed to determine if any adjustments to the information reported on the tax returns are needed. In addition, the IRS issues notices and contacts taxpayers to collect the delinquent taxes. If necessary, the IRS takes enforcement action, such as filing liens and seizing assets, to collect the taxes.

Between FYs 2010 and 2015, the IRS's budget has been reduced by approximately $1.2 billion. The IRS has seen a reduction of 21 percent of Automated Collection System contact representatives and 28 percent of Field Collection revenue officers. This has resulted in the Automated Collection System answering 25 percent fewer taxpayer calls since FY 2011 and taxpayers whose calls were answered spent an average of eight minutes (97 percent) longer waiting for a contact representative.

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[16] The Affordable Care Act requires the Exchanges to provide the IRS with information regarding individuals who are enrolled by the Exchange on a monthly basis. These data are referred to as Exchange Periodic Data.

[17] An Exchange is where taxpayers find information about health insurance options, purchase qualified health plans, and, if eligible, obtain help paying premiums.

[18] TIGTA, Ref. No. 2015-43-057, *Affordable Care Act: Interim Results of the Internal Revenue Service Verification of Premium Tax Credit Claims* (May 2015).

Additionally, in FY 2014, revenue officers collected $222 million (7 percent) less than in FY 2011.[19]

We expect that the increasing budgetary constraints will continue to impact IRS efforts to enforce tax compliance. The IRS Commissioner testified in March 2015 that the IRS will lose 1,800 key enforcement personnel during FY 2015 that it will be unable to replace. As a result, the IRS anticipates that fewer audits and fewer resources will be focused on collection, and estimates that as a result of these enforcement cuts, the Federal Government will lose at least $2 billion in revenue.[20]

TIGTA continues to audit the efficiency and effectiveness of the IRS's efforts to reduce the Tax Gap and improve voluntary compliance. In the area of partnership compliance, for example, the IRS initiated a Partnership Strategy in July 2012 to improve the partnership audit process in light of the significant increase in partnership filings and complexities associated with auditing partnership returns. TIGTA reviewed the partnership audit process and found that the IRS has no effective way to assess the productivity of its partnership audits because many complex partnerships have multiple layers of flow-through entities.[21] In order to track partnership audits, the IRS uses a decades old system that is unable to provide information on the total amount of taxes that are ultimately assessed to the taxable partners as a result of adjustments made to partnership returns. Therefore, the IRS is unable to assess the full impact of its partnership compliance activities.

Additionally, Congress enacted legislation in an effort to narrow the Tax Gap and increase voluntary compliance of businesses through information reporting. The legislation required information returns to be filed for reportable payment card transactions[22] starting in Calendar Year 2012. The IRS committed to a multiyear pilot initiative leveraging Form 1099-K, *Payment Card and Third Party Network Transactions*, information to reduce the Tax Gap. Included were backup withholding provisions that require payers to withhold 28 percent of the amounts reported on Forms 1099-K for payees that failed to provide a valid Taxpayer Identification Number. However, TIGTA found that payers are not in compliance with these withholding requirements.[23] For

[19] TIGTA, Ref. No. 2015-30-035, *Reduced Budgets and Collection Resources Have Resulted in Declines in Taxpayer Service, Case Closures, and Dollars Collected* (May 2015).
[20] Written Testimony of John A. Koskinen, Commissioner of the IRS, before the Senate Appropriations Committee, Subcommittee on Financial Services and General Government, dated March 3, 2015.
[21] TIGTA, Ref. No. 2015-30-004, *Additional Improvements Are Needed to Measure the Success and Productivity of the Partnership Audit Process* (Mar. 2015).
[22] A reportable payment card transaction involves a bank or other entity that makes a payment to a merchant or other business, in settlement of reportable payment card transactions, which includes credit cards, debit cards, and store-valued cards. The entity that transfers funds to the merchant's account is responsible for preparing and furnishing Form 1099-K, *Payment Card and Third Party Network Transactions*, to the merchant and to the IRS.
[23] TIGTA, Ref. No. 2015-40-089, *Additional Actions to Enforce Payment Card Reporting Requirements Could Reduce the Tax Gap* (Sept. 2015).

example, our review of Calendar Year 2013 Forms 1099-K identified 10,216 Forms 1099-K with a missing Taxpayer Identification Number. These Forms 1099-K reported gross transactions totaling more than $10.6 billion. As such, payers were required to withhold almost $3 billion from these payees, yet no withholding was taken.

FRAUDULENT CLAIMS AND IMPROPER PAYMENTS

The Office of Management and Budget describes an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. The Improper Payment Information Act (IPIA) of 2002[24] requires Federal agencies, including the IRS, to estimate the amount of improper payments and report to Congress annually on the causes of and the steps taken to reduce improper payments. The Improper Payment Elimination and Recovery Act of 2010[25] amended the IPIA by strengthening agency reporting requirements and redefining significant improper payments.

The Improper Payment Elimination and Recovery Act requires agencies to report an annual improper payment rate below 10 percent. The IRS provided all required improper payment information for inclusion in the *Department of the Treasury Agency Financial Report Fiscal Year 2014*, with the exception of reporting an overall Earned Income Tax Credit improper payment rate below 10 percent.[26] The IRS has made little improvement in reducing Earned Income Tax Credit improper payments since it has been required by the IPIA to provide an estimate of these payments to Congress. The Earned Income Tax Credit is the largest refundable credit[27] based on total claims paid, and it continues to be vulnerable to a high rate of noncompliance, including incorrect or erroneous claims caused by taxpayer error or resulting from fraud.

Additionally, IRS processes for assessing the risk of improper payments do not accurately reflect the risk associated with the Additional Child Tax Credit.[28] Each year since FY 2011, the IRS has continually rated the risk of improper payments associated with the Additional Child Tax Credit as low. However, our review of the IRS's own enforcement data indicates that the Additional Child Tax Credit improper payment rate is similar to that of the Earned Income Tax Credit. We estimate that the Additional Child Tax Credit improper payment rate for FY 2013 is between 25.2 percent and 30.5 percent, with potential improper payments totaling between $5.9 billion and $7.1 billion.

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[24] Pub. L. No. 107-300, 116 Stat. 2350.
[25] Pub. L. No. 111-204, 124 Stat. 2224.
[26] TIGTA, Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* (Apr. 2015).
[27] A refundable credit allows taxpayers to reduce their tax liability to below zero and thus receive a tax refund, even if no income tax was withheld or paid.
[28] TIGTA, Ref. No. 2014-40-093, *Existing Compliance Processes Will Not Reduce the Billions of Dollars in Improper Earned Income Tax Credit and Additional Child Tax Credit Payments* (Sept. 2014).

Further, the IRS does not have effective processes to identify erroneous claims for education credits.[29] The Taxpayer Relief Act of 1997[30] created two permanent education tax credits, the Hope Credit and the Lifetime Learning Credit. The American Recovery and Reinvestment Act of 2009[31] temporarily replaced the Hope Credit with a refundable tax credit known as the American Opportunity Tax Credit. This credit was initially set to expire at the end of the Calendar Year 2010, but has been extended through Calendar Year 2017. Based on our analysis of education credits claimed and received on Tax Year 2012 tax returns, we estimate that more than 3.6 million taxpayers received more than $5.6 billion ($2.5 billion in refundable credits and $3.1 billion in nonrefundable credits) in potentially erroneous education credits.

Another problem with a significant impact on tax administration is identity theft. The IRS has described identity theft as one of its "Dirty Dozen" scams.[32] Because new identity theft patterns are constantly evolving, the IRS recognizes that it needs to adapt its detection and prevention processes. While TIGTA found that efforts continue to result in increased detection and prevention of identity theft returns, the IRS's ability to stop this problem is still limited.[33] Further, the IRS still does not have timely access to third-party income and withholding information. Most of the third-party income and withholding information is not received by the IRS until well after the tax return filing season begins. The IRS continues to propose legislation to accelerate and expand its access to data that would further improve its detection efforts.

ACHIEVING PROGRAM EFFICIENCIES AND COST SAVINGS

Achieving program efficiencies and cost savings is imperative, as the IRS must continue to carry out its mission with a significantly reduced budget. The IRS must continue to identify and implement innovative cost-saving strategies to enforce the law with integrity and fairness and provide America's taxpayers with top quality service by helping them understand and meet their tax responsibilities. TIGTA has identified a number of areas in which the IRS can achieve cost savings, more efficiently use its limited resources, and make more informed business decisions.

TIGTA recently completed an audit to determine whether there was duplication in risk assessment services performed by the IRS and the Department of Homeland Security's Federal Protective Service (FPS).[34] The FPS has the responsibility to conduct risk

[29] TIGTA, Ref. No. 2015-40-027, *Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions* (Mar. 2015).
[30] Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of the U.S. Code).
[31] Pub. L. No. 111-5, 123 Stat. 115, *306, subsequently amended by the Tax Relief Unemployment Insurance Reauthorization and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296.
[32] Compiled annually, the "Dirty Dozen" lists a variety of common scams that taxpayers may encounter.
[33] TIGTA, Ref. No. 2015-40-026, *Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft* (Apr. 2015).
[34] TIGTA, Ref. No. 2015-10-077, *To Avoid Duplication, the Internal Revenue Service Should Make Use of Federal Protective Service Risk Assessments* (Sept. 2015).

assessments for all the facilities under its purview, including more than 600 IRS facilities throughout the country. TIGTA found that while the IRS is required to pay the FPS for risk assessments, the IRS does not fully benefit from the information provided in these risk assessments. Specifically, the IRS does not use FPS risk assessments or evaluate recommendations that FPS inspectors made to improve the security at IRS facilities. In addition, the IRS does not consider when a facility last received a risk assessment from the FPS when scheduling its own risk assessments. As a result, the IRS conducted 57 risk assessments at facilities that had already received an FPS risk assessment within the last two years. The IRS paid almost $100 million in basic security fees to the FPS for FYs 2010 through 2014, which included charges for FPS-prepared risk assessments; however, the IRS also incurred additional costs to perform its own risk assessments of the same facilities.

TIGTA identified two ways in which the Federal Employee/Retiree Delinquency Initiative[35] program (Initiative program) can be improved.[36] The first involves the Federal Payment Levy Program (FPLP), which allows the IRS to levy up to 15 percent of certain Federal payments, including wages, to delinquent taxpayers. Federal payments for certain Federal employees are excluded from the FPLP due to legal or policy constraints, *e.g.*, bankruptcy or military service men and women in combat zones, but the IRS excludes certain other Federal payments from the FPLP without a legal or articulated policy basis. TIGTA forecasts that expanding the FPLP to include more Federal payments could potentially increase revenue by approximately $18.3 million over the next five years. The second improvement opportunity involves the IRS's policy to handle many Initiative program cases manually. Initiative program cases bypass the IRS's other Automated Collection System tools that can systemically identify taxpayer assets for levy in favor of manual handling. With its reduced budget, it is even more important for the IRS to maximize the use of its automated systems whenever possible because manual processes can prove to be inefficient and more costly.

TIGTA also determined that the IRS paid monthly service fees for almost 6,800 wireless devices that were not captured in inventory records.[37] Because these devices are not tracked in inventory, the IRS does not have assurance that the employees using them have a valid business need. While service fees associated with almost 6,800 devices may be justifiable, the IRS is not in a position to determine which fees are valid because inventory and billing records cannot be reconciled. The annualized cost equates to nearly $2 million in service fees for devices that were not inventoried in FY 2013.

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[35] A program that promotes Federal tax compliance among current and retired Federal employees.
[36] TIGTA, Ref. No. 2015-30-051, *Most Federal Employee/Retiree Delinquency Initiative Cases Are Resolved With the Collection of Revenue; However, Some Program Improvements Can Be Made* (June 2015).
[37] TIGTA, Ref. No. 2014-10-075, *Wireless Telecommunication Device Inventory Control Weaknesses Resulted in Inaccurate Inventory Records and Unsupported Service Fees* (Sept. 2014).

IMPROVING TAX SYSTEMS AND ONLINE SERVICES

Successful modernization of IRS systems and the development and implementation of new information technology applications are critical to meet the IRS's evolving business needs and to enhance services provided to taxpayers.[38] The IRS has acknowledged that the current technology environment has raised taxpayers' expectations for online customer service interactions and it needs to meet these expectations. This is particularly important because as the IRS has absorbed budget cuts, it has directed more taxpayers to technology-based self-assistance options such as its IRS2Go app; YouTube channels; interactive self-help tools on IRS.gov; and Twitter, Tumblr, and Facebook accounts.

However, earlier this year, the IRS Commissioner testified that the IRS expected to absorb budget cuts of more than $200 million by delaying critical information technology investments. This includes delaying replacement of aging information technology systems and not investing upfront money to develop future capabilities, such as improved web services that would enable taxpayers to more easily obtain information and improve their interaction with the IRS.

The IRS Restructuring and Reform Act of 1998[39] mandated that the IRS, not later than December 31, 2006, develop procedures for taxpayers and their designees to review taxpayers' accounts electronically. The Service on Demand Initiative is the IRS's latest attempt to deliver such capability and contains specific projects that will provide online account access options. However, the projects intended to provide these online options ultimately cannot be delivered until the IRS commits to fully completing three key "pillar" information technology projects. The completion of these projects is needed to provide the account features to enable taxpayers to view their accounts online, to accurately authenticate their identities online, and to enable the IRS and taxpayers to communicate with secure electronic messages. The recent breach of the IRS's Get Transcript application highlights the importance of accurately authenticating taxpayers' identities online because criminals used taxpayer-specific data acquired from non-IRS sources to gain access to information for more than 330,000 taxpayer accounts.[40]

With its limited resources, the IRS needs to prioritize projects to ensure enhanced service to taxpayers. TIGTA determined that three IRS-developed projects, which would provide taxpayers with dynamic online account access capabilities, were not ranked among the top 20 projects the IRS recommended for development.[41] These

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[38] For Fiscal Year 2016, we have replaced the Modernization challenge and incorporated it within the Improving Tax Systems and Online Services challenge to reflect the IRS's expanded use of technology to provide taxpayers online services.
[39] 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.).
[40] IRS, *Additional IRS Statement on the "Get Transcript" Incident*, dated August 17, 2015.
[41] TIGTA, Ref. No. 2015-40-053, *Taxpayer Online Account Access Is Contingent on the Completion of Key Information Technology Projects* (May 2015).

three projects focused on providing taxpayers with online account capabilities that would establish self-service options for taxpayers to report identity theft and lock their online tax account from potential abuse by identity thieves. However, despite the impact identity theft has on tax administration and taxpayers, the IRS ranked projects to establish IRS workload management practices and a unified case management system higher.

PROVIDING QUALITY TAXPAYER SERVICE OPERATIONS

Providing taxpayers with quality customer service is a key component in the IRS's mission. Ensuring that taxpayers understand and meet their tax responsibilities is crucial for the IRS in its effort to encourage voluntary compliance with the tax laws. Resolving taxpayer questions before tax returns are filed helps avoid unintentional errors and also reduces taxpayer burden that results from the issuance of post-filing notices and correspondence. Further, successfully addressing and resolving taxpayer inquiries through a quality customer service process allows the IRS to direct its limited resources more efficiently.

In the past, TIGTA has evaluated the IRS's efforts to provide quality customer service and made recommendations for areas of improvement. Although the IRS has implemented certain procedures to better assist taxpayers, budget reductions pose a significant challenge and continue to force the IRS to cut service to taxpayers. As demand for taxpayer services continues to increase, resources devoted to customer service have decreased, thereby affecting the quality of customer service that the IRS is able to provide.

There has been a decline in the IRS's ability to provide a sufficient level of customer service in each of the channels that taxpayers use, including telephone, face-to-face assistance at Taxpayer Assistance Centers, and correspondence. Despite the various options, most taxpayers continue to use the telephone as the primary method to make contact with the IRS. The IRS continues to struggle in providing high-quality customer service over the telephone.

As a result of the budget cuts, the IRS forecasted a 37.1 percent Level of Service for the 2015 Filing Season. As of May 2, 2015, there were approximately 83.2 million attempts by taxpayers to contact the IRS by calling the various customer service toll-free telephone assistance lines seeking help to understand the tax law and meet their tax obligations.[42] IRS assistors answered approximately 8.3 million calls and provided a 37.6 percent Level of Service with a 23.5 minute Average Speed of Answer. In comparison, the Level of Service for the 2014 Filing Season was 70.8 percent, with the

[42] The IRS refers to the suite of 29 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

IRS answering more than 11 million telephone calls with a 14.4 minute Average Speed of Answer.[43]

Each year, many taxpayers also seek assistance from one of the IRS's 380 walk-in offices, called Taxpayer Assistance Centers. However, the IRS estimates that the number of taxpayers it will assist at its Taxpayer Assistance Centers will decrease this fiscal year. The IRS assisted more than 5.5 million taxpayers in FY 2014 and plans to assist 5.3 million taxpayers in FY 2015 (a 4 percent decrease). Further, the IRS's ability to process taxpayer correspondence in a timely manner has also declined. The backlog of paper correspondence inventories remains high. The over-age inventory[44] rose from 32.7 percent of inventory in 2014 to 36.1 percent in 2015.

In an effort to continue to redirect taxpayers to online services, the IRS has expanded its online tools available on IRS.gov and offers more self-assistance options that taxpayers can access 24 hours a day, seven days a week. The IRS reported more than 327 million visits to IRS.gov this filing season as of May 9, 2015. Taxpayers continue to desire electronic products and services that enable them to interact and communicate with the IRS. In response, the IRS continues to expand the information and tools available online to assist taxpayers. The IRS's goal is to provide taxpayers with dynamic online account access that includes viewing their recent payments, making minor changes and adjustments to their accounts in real time, and corresponding digitally with the IRS to respond to notices or complete required forms.

Although the IRS Commissioner noted that the IRS expects to deliver dynamic online account access capability in three to five years, funding needs to be committed to fully complete the key information technology projects. Failure to dedicate funding to this effort will cause the IRS to miss opportunities to fully benefit from the cost savings and improved customer service that can be achieved by providing online account access, including reducing the reliance on traditional service channels such as telephones, paper correspondence, and face-to-face contact that are currently experiencing heavy traffic.[45]

We also determined that victims of identity theft experienced long delays in having their tax accounts resolved.[46] Our review of a statistically valid sample of 100 identity theft tax accounts resolved in the Accounts Management function between October 1, 2012, and September 30, 2013, identified that the IRS took an average 278 days to resolve the tax accounts. In addition, our review identified that the IRS made errors on the tax accounts of victims of identity theft, resulting in the delay of refunds or the victim

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[43] TIGTA, Ref. No. 2015-40-080, *Results of the 2015 Filing Season* (Aug. 2015).
[44] Correspondence is generally considered over-age when it has been in inventory for more than 45 calendar days.
[45] TIGTA, Ref. No. 2015-40-053, *Taxpayer Online Account Access Is Contingent on the Completion of Key Information Technology Projects* (May 2015).
[46] TIGTA, Ref. No. 2015-40-024, *Victims of Identity Theft Continue to Experience Delays and Errors in Receiving Refunds* (Mar. 2015).

receiving an incorrect refund amount. For example, of the 100 tax accounts that TIGTA reviewed, the IRS did not correctly resolve 17 (17 percent) accounts. Errors result in delayed refunds and require the IRS to reopen cases and take additional actions to resolve the errors. Based on the results of the review of the 100 identity theft tax accounts, we estimate that 25,565 (10 percent) of the 267,692 taxpayers whose accounts were resolved during the period October 1, 2012, to September 30, 2013, may have been resolved incorrectly, resulting in the issuance of delayed or incorrect refunds. This wastes additional resources needed to resolve the errors and further burdens victims of tax-related identity theft.

GLOBALIZATION

The scope, complexity, and magnitude of international financial transactions continue to present significant enforcement challenges for the IRS. As the IRS noted in its most recent strategic plan, the evolution and proliferation of virtual commerce has expanded the exchange of goods, services, and currencies – real and virtual – across jurisdictions, further complicating tax administration. In addition, businesses with U.S. tax obligations are increasingly adopting more complex incorporation structures, shifting away from C corporations and moving towards flow-through entities, such as partnerships and S corporations.[47]

The IRS has encouraged taxpayers to voluntarily disclose their foreign accounts and pay the amount they owe through the Offshore Voluntary Disclosure Program. Since its establishment in 2009, this Program has resulted in more than 50,000 disclosures of underpaid or unpaid taxes and the collection of more than $7 billion in back taxes, interest, and penalties. Another tool that the IRS expects will help improve offshore tax compliance is the Foreign Account Tax Compliance Act (FATCA).[48] This law requires foreign financial institutions to report information to the IRS about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. More than 160,000 foreign financial institutions have registered under the FATCA and recently, in March 2015, began providing the IRS with information.

In an audit assessing the IRS's progress in implementing the FATCA, TIGTA found that the IRS has taken steps to provide information to affected stakeholders that explain the FATCA requirements and expectations.[49] However, TIGTA identified that improvements are required to ensure compliance with the FATCA. If compliance plans are not properly documented, implementation and performance of compliance activities could experience unnecessary delays. TIGTA also identified some limitations with the IRS's

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[47] *Internal Revenue Service Strategic Plan – FY 2014-2017* (IRS Publication 3744) (Rev. June 2014).
[48] Pub. L. No. 111-147, Subtitle A, 124 Stat 71, *96-116 (2010)(codified in scattered sections of 26 U.S.C.).
[49] TIGTA, Ref. No. 2015-30-085, *The Internal Revenue Service Has Made Progress in Implementing the Foreign Account Tax Compliance Act* (Sept. 2015).

processing of paper Forms 8938, *Statement of Specified Foreign Financial Assets*, that if not properly addressed could limit the IRS's ability to make informed decisions and achieve its compliance objectives related to the FATCA.

The United States generally taxes U.S. citizens and resident aliens[50] on their worldwide income and foreign persons on their U.S. source income. The Foreign Tax Credit (FTC) is intended to reduce the double taxation burden that would otherwise occur when foreign source income is taxed by both the United States and the foreign country from which the income is derived. The FTC can significantly affect the amount of taxes paid by individuals on U.S. tax returns. In Tax Year 2013, nearly 7.4 million individual tax returns were filed claiming approximately $16.7 billion in FTCs.

TIGTA determined that the IRS does not have sufficient controls and processes in place to identify erroneous FTC claims.[51] TIGTA's analysis of paper and electronically filed individual tax returns for Tax Years 2010 through 2012 identified that the IRS potentially: improperly allowed $94.9 million in FTCs on 65,499 tax returns; allowed taxpayers to file 16,058 tax returns that claimed nearly $2.9 million in FTCs as a deduction, as well as a credit on the same foreign taxes paid; and allowed nearly $40 million in erroneous FTCs on 188,102 tax returns when third-party information return documents did not support the FTCs claimed.

TAXPAYER PROTECTION AND RIGHTS

The IRS must ensure that tax compliance activities are balanced against the rights of the taxpayers to receive fair and equitable treatment. In June 2014, the IRS updated Publication 1, *Your Rights as a Taxpayer*. Also referred to as the Taxpayer Bill of Rights, this publication outlines the rights of the taxpayer and the processes for examination, appeal, collection, and refunds. The IRS continues to dedicate significant resources and attention to implementing the taxpayer rights provisions of the IRS Restructuring and Reform Act of 1998. The following audits related to taxpayer rights provisions are mandated to be completed annually by TIGTA: Notices of Levies; Restrictions on the Use of Enforcement Statistics to Evaluate Employees; Fair Debt Collection Practices Act[52] Violations; Notices of Liens; Seizures; Illegal Tax Protestor Designations; Statute of Limitations for the Assessment of Additional Taxes and Penalties; Collection Due Process Appeals; Denial of Requests for Information; Restrictions on Directly Contacting Taxpayers Instead of Authorized Representatives; and Separated or Divorced Joint Filer Requests.

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[50] An individual who is not a U.S. citizen who meets either the "green card" test of holding an immigrant visa or the physical presence of being in the United States for at least 31 days during the current calendar year and a total of 183 days during the three-year period that includes the current year and the two preceding years.

[51] TIGTA, Ref. No. 2015-30-052, *Improvement Is Needed in Compliance Efforts to Identify Unsupported Claims for Foreign Tax Credits* (July 2015).

[52] 15 U.S.C. §§1601 note, 1692-1692o (2006).

In general, the IRS has improved its compliance with these statutory taxpayer rights provisions and is documenting its protection of taxpayer rights. However, during the review of the IRS's compliance with Notice of Federal Tax Lien due process procedures, TIGTA found that the IRS did not notify the taxpayers' representatives of the Notice of Federal Tax Lien filings as required.[53] Based on the sample results, TIGTA estimated that 24,237 taxpayers may have been adversely affected because the IRS did not follow requirements to notify the taxpayers' representatives of the taxpayers' rights related to the Notices of Federal Tax Lien.

During the review of the IRS Office of Appeals Collection Due Process Program, TIGTA identified errors relating to the determination of the Collection Statute Expiration Date (CSED) on taxpayer accounts.[54] The CSED is the expiration of the time period established by law to collect taxes. From a statistically valid sample, TIGTA identified instances in which the IRS incorrectly extended the CSED, allowing the IRS additional time it should not have had to collect the delinquent taxes. Based on the sample results, TIGTA projected that 1,464 of the 34,155 Collection Due Process taxpayer cases closed in FY 2014 may have an incorrect CSED with time extended in error.

During the review of the IRS's compliance with legal guidelines when conducting seizures of taxpayers' property, TIGTA found that the IRS generally followed the guidelines. However, we identified 24 instances, involving 21 seizures, in which the IRS did not comply with a particular Internal Revenue Code section and the related Internal Revenue Manual requirement or the IRS Restructuring and Reform Act of 1998.[55] Failure to adhere to legal and internal guidelines could result in the abuse of taxpayers' rights or inequitable treatment of taxpayers.

The IRS is continuously under attack by criminals using the tax administration system for personal gain in various ways. These scams, and the methods used to perpetrate them, are constantly changing, require constant monitoring by the IRS, and adversely impact taxpayers. For at least the last decade, the IRS has provided the public with information about what it sees as the "Dirty Dozen" tax scams on its website. These scams range from offshore tax avoidance to fake charities and inflated refund claims. Compiled annually, the "Dirty Dozen" lists a variety of common scams that taxpayers may encounter.

The phone impersonation scam has proven to be so large that it is one of TIGTA's Office of Investigation's top priorities, and it has also landed at the top of the IRS's "Dirty Dozen" tax scams this year. It is a surprisingly effective and fast way to steal taxpayers'

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[53] TIGTA, Ref. No. 2015-30-055, *Fiscal Year 2015 Statutory Review of Compliance With Notice of Federal Tax Lien Due Process Procedures* (June 2015).
[54] TIGTA, Ref No. 2015-10-068, *Review of the Office of Appeals Collection Due Process Program* (Aug. 2015).
[55] TIGTA, Ref. No. 2015-30-048, *Fiscal Year 2015 Review of Compliance With Legal Guidelines When Conducting Seizures of Taxpayers' Property* (June 2015).

money, and in this fast-paced electronic environment, the money can be gone before the victims ever realize that they have been scammed. The hundreds of thousands of complaints we have received about this scam makes it the largest, most pervasive impersonation scam in the history of our agency. It has claimed thousands of victims with reported losses totaling more than $22 million as of August 2015.

HUMAN CAPITAL

People are the Federal Government's most critical asset because they play such a vital role in achieving agencies' missions and delivering services to stakeholders. The Government Accountability Office has designated Strategic Human Capital Management as a high risk since 2001. In its most recent High-Risk report, it noted that current budget and long-term fiscal pressures, declining levels of employee satisfaction, the changing nature of Federal work, and a potential wave of employee retirements threaten the Government's capacity to address many evolving, national issues.[56]

At most Federal agencies, personnel costs account for the large majority of operating costs. The IRS is no exception, with approximately 75 percent of its budget going toward personnel costs. Between FYs 2010 and 2014, the IRS lost approximately 13,000 full-time employees and expects to lose an additional 3,000 employees through attrition in FY 2015.[57] Additionally, by the end of FY 2017, approximately 69 percent of all IRS executives and 48 percent of the IRS's non-executive managers are projected to be eligible for retirement.[58]

Although the IRS faces pressure to fill staffing vacancies when the budget permits, the IRS must ensure that it hires and retains only well-qualified individuals. TIGTA found that between January 2010 and September 2013, the IRS hired hundreds of former employees with prior substantiated conduct or performance issues, including tax issues.[59] Although these individuals may meet Office of Personnel Management suitability standards, rehiring prior employees with known conduct and performance issues presents an increased risk to the IRS and taxpayers.

Further, TIGTA found that the IRS's process to address tax violations by its employees could be improved.[60] TIGTA reviewed records for cases closed in FYs 2004 through 2013 and found that 1,580 employees were found to be willfully tax noncompliant. While the IRS Restructuring and Reform Act of 1998 states that the IRS shall terminate

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[56] Government Accountability Office, GAO-15-290, *High Risk Series – An Update* (Feb. 2015).
[57] Written Testimony of John A. Koskinen, Commissioner of the IRS, before the House Ways and Means Committee, Subcommittee on Oversight, dated April 22, 2015.
[58] TIGTA, Ref. No. 2013-10-017, *Improvements Have Been Made to Address Human Capital Issues, but Continued Focus Is Needed* (Jan. 2013).
[59] TIGTA, Ref. No. 2015-10-006, *Additional Consideration of Prior Conduct and Performance Issues Is Needed When Hiring Former Employees* (Dec. 2014).
[60] TIGTA, Ref. No. 2015-10-002, *Review of the Internal Revenue Service's Process to Address Violations of Tax Law by Its Own Employees* (Apr. 2015).

employees who willfully violate tax law, it also gives the IRS Commissioner the sole authority to mitigate cases to a lesser penalty. Over this 10-year period, 620 employees (39 percent) with willful tax noncompliance were terminated, resigned, or retired. For the other 960 employees (61 percent) with willful tax noncompliance, the proposed terminations were mitigated to lesser penalties such as suspensions, reprimands, or counseling.

The anticipated retirements and reduction in employees possessing a very specialized skillset and institutional knowledge are particularly challenging as the IRS works to process an increasing number of tax returns, combat tax refund fraud and identity theft, and effectively manage new or enhanced responsibilities brought on by tax code changes. Faced with a shrinking workforce and continued budgetary pressure, the IRS will be challenged to successfully achieve its mission. Further, as the agency primarily responsible for administering Federal tax law, the IRS must ensure that its employees are held to the highest standards to maintain the public's confidence.

CONCLUSION

This memorandum is provided as our annual summary of the most serious major management and performance challenges confronting the IRS in FY 2016. TIGTA's *Fiscal Year 2016 Annual Audit Plan* contains our proposed reviews, which are organized by these challenges, in order of priority. If you have any questions or wish to discuss our views on the challenges in greater detail, please contact me at (202) 622-6500.

cc: Deputy Secretary
Assistant Secretary for Management and Chief Financial Officer
Commissioner of Internal Revenue