



STATEMENT OF COLLEEN M. KELLEY
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ON

A CLOSER LOOK AT THE SIZE AND SOURCES OF THE TAX GAP

SUBMITTED TO

SUBCOMMITTEE ON TAXATION AND IRS OVERSIGHT
SENATE FINANCE COMMITTEE

JULY 26, 2006

Chairman Kyl, Ranking Member Jeffords, and members of the Subcommittee, my name is Colleen Kelley and I am the National President of the National Treasury Employees Union (NTEU). As you know, NTEU represents 150,000 federal employees in 30 federal agencies and departments, including the men and women who work at the Internal Revenue Service. I appreciate your initiative in holding this hearing on an issue of major importance to taxpayers across the country, the tax gap. Many of our workers handle responsibilities on a daily basis that revolve around closing the tax gap, and I am pleased to submit this statement to the subcommittee offering our input.

As you know, the tax gap is the difference between the amount of tax that should have been paid and the amount that was actually received by IRS in a given tax year. In April of this year, the IRS reported that the gross tax gap is estimated to be approximately \$345 billion. (IRS Updates Tax Gap Estimate," IR 2006-028, www.irs.gov/newsroom/). This is a sizable debt owed to the government but one that can be addressed. In his testimony before the Senate Budget Committee in February of 2006, Comptroller General of the United States, David Walker, pointed out that even modest progress on the tax gap would likely yield significant revenue. Each 1 percent reduction could yield \$3 billion annually (GAO) 06-453T).

Additional Staffing Required

My message on the tax gap is simple: the IRS needs more employees on the frontlines of tax compliance and enforcement to help it close the \$345 billion tax gap. It also needs a dedicated funding approach which I will address later in this statement. Rather than move forward with its plans to drastically cut customer service in order to expand its enforcement role, the IRS needs to strike a balance between offering adequate opportunities for taxpayers to voluntarily comply and enforcing the tax code. NTEU agrees with GAO's earlier finding on in its tax gap report (GAO-05-753) that a more regular compliance assessment is needed if the IRS wishes to obtain a clearer picture of the extent of the tax gap. But I would emphasize that the IRS should determine those factors which encourage and enable taxpayers to voluntarily comply as well as determine reasons for noncompliance.

The bottom line is the IRS has the expertise to improve compliance but lacks the necessary personnel. Thus far, it can point to successes in increased collections of delinquent tax debt. The President's own fiscal 2007 budget proposal trumpets in several places the increased tax collections produced by IRS's own employees (without the use of private collection agencies). For example, it mentions the increased collections of delinquent tax debt from \$34 billion in 2001 to \$47 billion in 2005, an increase of 38 percent". (Pages 227, 233 of FY 2007 Budget). In its FY 2006 Budget in Brief, the Treasury Department acknowledged the IRS "Collected more than two trillion dollars in revenue with \$47.3 billion collected through enforcement activities, a 10 percent increase from FY 2005". (p. 62)

Despite these accomplishments, front line workers are thinly spread and are submerged with handling day-to-day responsibilities while also facing serious job security concerns. Just two days ago, the *New York Times* ran a story titled, "IRS to Cut Tax Auditors" which details a planned reduction of 157 estate tax lawyers – almost half of the agency's estate tax lawyers -

who audit some of the wealthiest Americans. These Americans are subject to the gift and estate taxes which, as you know, only touches the very affluent. Finding a mistake in these returns can often produce several thousand dollars per return. It makes no sense for IRS to be eliminating key workforce positions in an area that could produce significant revenue to help close the tax gap.

While NTEU agrees with IRS' goal of enhancing tax compliance and enforcement, we don't agree with the approach of eliminating front-line customer service employees in order to pay for additional compliance efforts. As the number of tax returns continues to grow, the number of IRS employees continues to shrink. As the Oversight Board pointed out in its 2003 Annual Report, IRS workload has increased by 16 percent while at the same time the number of full time equivalent employees has decreased by 16 percent from 1999 to 2002. According to the 2004 IRS Data Book, the number of IRS employees dropped from 106,642 in 1996 to 98,735 in 2004.

The problem of the shrinking workforce is exacerbated by a number of factors, including an increasingly complex tax code and a high number of tax returns—paper as well as electronic returns. This has led to a serious decline in the ability of the IRS workforce to handle increasing demands. Combined Collection and Examination function enforcement staff declined from 25,000 at the beginning of FY 1996 to 16, 000 at the end of FY 2003, a 36 percent decline.

In its FY 2006 IRS Budget/Special Report, the IRS Oversight Board stated that it “agrees that investing in enforcement does pay for itself many times over, not only in increased revenues but by reinforcing the belief that all taxpayers are paying their fair share.” In its FY 2007 Special Report, the Oversight Board recommended an increase in FTEs to prevent tax gap growth including 748 FTEs to “address the tax gap associated with small business and self-employed taxpayers”...86 FTEs to “curtail non-compliance in abusive schemes, corporate fraud, non-filers, employment tax and Bank Secrecy Act,” and 62 FTEs “to address fraudulent payments made through the EITC program.” (p.22)

Also, the IRS should look at the management to bargaining unit employee ratio to find much needed resources for additional collection work. Although the number of frontline employees who do the work at the IRS has decreased by 5.1 percent since 2000, the number of managers who supervise these employees has *increased* by 1 percent over this same period. If the IRS decreased the number of managers and management officials at the same rate as it has decreased its rank and file employees, the Agency could put the savings toward bolstering Collections work.

Experiencing an increase in workload while witnessing a downturn in personnel has taken its toll on some functions. In its September 2003 report, the Treasury Inspector General for Tax Administration (TIGTA) indicated that the Automated Collection System (ACS) function was a “critical Collection operation,” collecting nearly \$1 million per FTE in FY 2002. ACS is a system that is operational in 10 service centers to allow the IRS to contact taxpayers by telephone and collect delinquent taxes.

It is our understanding ACS staff is at the current time so overwhelmed with incoming call responsibilities, they simply do not have the manpower to make basic outgoing calls to collect taxes. This is an obvious area where increased staffing could help lower the tax gap.

Customer Service

Congress must continue to reject IRS' plans to implement draconian cuts to customer service. Customer service is one half of the compliance equation. The IRS' plan to close 67 Taxpayer Assistance Centers (TACs) across the country last year was counterproductive to the mission of the IRS. This plan will exacerbate—not shrink—the tax gap. IRS Taxpayer Assistance Centers are taxpayers' frontline source for personal, face-to-face tax help. Taxpayers who have complex issues, need to resolve a tax problem, or are more comfortable talking with someone in person can visit a local Taxpayer Assistance Center. IRS representatives in these offices can help with inquiries or adjustments to tax accounts, payment plans for those who owe tax and cannot pay the full amount, questions about IRS letters and notices, and levies on wages or bank accounts.

Seniors, who rely on face-to-face contact more than younger taxpayers, will be forced to travel farther distances in order to get the tax assistance they need if the IRS follows through with its cuts to customer service. This also means that minorities and low-income taxpayers, who rely on the Centers to help with language barriers, the earned-income tax credit and general tax preparation, will also see the tax services they rely on cut.

Last year, the Treasury Inspector General for Tax Administration Russell George stated before the Senate Transportation, Treasury, HUD Appropriations Subcommittee (April 7, 2005), "TIGTA believes this information is insufficient to draw conclusions on the capability and likelihood that taxpayers who have used these centers in the past will be willing to use alternative methods of seeking help, such as the internet or telephone. I strongly recommend that the IRS further research these issues before closing TACs."

The 2004 IRS Oversight Board Tax Compliance Study found that "the most heavily relied upon source of tax information and advice are IRS representatives" (82 percent see them as very/somewhat valuable). The study further shows that more than 90 percent of those surveyed said that IRS customer service is either very or somewhat important to them.

The statements from these reliable sources point to one conclusion: maintain customer service options for taxpayers. Both chambers of Congress also came to same conclusion with the language passed in H.R. 3058, the Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, 2006 which temporarily prevents cuts to customer service. Customer service is a critical part of the compliance equation and the IRS must not be allowed to slash customer service this year, or next year, for the sake of bolstering enforcement.

Private Tax Collection

NTEU strongly opposes the Administration's plan to privatize IRS tax collection, as

authorized by Congress in the American Jobs Creation Act of 2004. Under the statute, the IRS would be permitted to hire private sector debt collectors and pay them a bounty of up to 25 percent of the money they collect. NTEU opposes this short-sighted proposal, anticipates its complete failure as witnessed in a similar 1996 pilot program and will continue to work towards its repeal.

The House has twice signaled its bipartisan disapproval of privatizing tax collections by passing legislation that would prevent the program from moving forward. This year, in its FY 2007 Treasury Transportation appropriations bill, an amendment offered by Rep. Steven Rothman (D-NJ) received bipartisan support and was included in the House-passed bill to bar IRS from spending funds on the tax collection program.

Representatives Rob Simmons (R-CT) and Chris Van Hollen (D-MD) introduced H.R. 1621, The Taxpayer Protection Act of 2005. The legislation would repeal the IRS' recently enacted authority to hire private debt collectors to collect tax debt. The bill currently has 78 bipartisan cosponsors. The Taxpayer Protection Act would undo a serious mistake and NTEU strongly supports this legislation.

Proposals to allow private collection agencies to collect taxes on a commission basis have been around for a long time. As far back as 1986, the Reagan administration opposed the concept of privatizing tax collections. The Treasury Department warned then of considerable adverse public reaction to such a plan, and emphasized the importance of not compromising the integrity of the tax system, which is a longstanding inherently governmental function. President Reagan's Administration said this about such a proposal:

"The Department strongly opposes contracting out the collection of taxes because it is likely to result in considerable adverse public reaction. The public must be assured at all times that the person collecting taxes derives no personal benefits from that activity and that the integrity of the tax system will not be compromised." (Treasury Department Statement to the House Judiciary Committee, August 8, 1986).

The IRS' proposal would risk the loss of confidentiality of millions of taxpayers' private information, would provide incentives for the use of abusive tactics by private debt collectors, and would cost U.S. citizens much more money than if IRS employees did the job. A two-year pilot project in 1996 was so unsuccessful it was cancelled after one year. The pilot project lost money, did not provide adequate protection of sensitive taxpayer data and allowed hundreds of taxpayers to be called outside of the times set by the Fair Debt Collection Practices Act—including calls at 4:19 a.m. (IRS Internal Audit Report No. 080805, December 19, 1997).

The National Taxpayer Advocate Nina Olson has also expressed her concerns about handing this work over to private collection agencies (PCAs) in lieu of keeping it in-house. In her "Fiscal year 2006 Objectives Report to Congress" Ms. Olson stated, "the National Taxpayer Advocate has significant concerns about supplanting the trained professionals at the IRS with private debt collectors. A primary concern is the quality and quantity of training received by IRS employees versus the training received by private collection representatives." Although the IRS has attempted to convince skeptics that the PCAs will receive adequate training, you simply cannot compare the years of dedicated service and successful performance of IRS employees to

the temporary jobs of private collection agency employees. No amount of training can replace the institutional knowledge and respect for tax compliance and enforcement exhibited by IRS employees.

Dedicated Funding Stream

If the Congress is serious about eliminating the tax gap, my second message is it should enact a dedicated funding stream to hire IRS personnel outside of the ordinary budget process. There is precedent for this in IRS enforcement.

One of the most often heard arguments in favor of the use of private collection agencies is that if they are paid out of the proceeds of what they collect; it increases the IRS' enforcement capabilities without having to increase appropriations. Numerous Congressional supporters said they would prefer to have tax collection done by federal employees, but would go along with the use of private collection agencies solely because it avoids the difficult issue of getting Congress to approve additional appropriations for the IRS.

The statute that gives the IRS the authority to use PCAs allows 25 percent of collected revenue to be returned to the collection companies as payment and 25 percent to be retained by the IRS for enforcement efforts, thereby circumventing the appropriations process altogether.

There is nothing magical about revenues collected by private collection companies. If those revenues could be dedicated directly to contract payments and IRS enforcement efforts, there is no reason some small portion of other revenues collected by IRS employees couldn't be dedicated to IRS enforcement efforts. This would allow for increased enforcement by IRS employees, which most people indicate is the preferable route and eliminate large payments (up to 25% of collections) to private collection companies, significantly increasing net revenue to the General Treasury. While legislation would be required to allow for this kind of dedication of revenue, I believe the precedent has now been set with the private collection agency funding provisions. Congress should consider supporting this approach as a common sense way to make real progress in closing the tax gap, lowering our deficits and making more funding available for our Nation's critical needs.

Flawed Revenue Scoring

It is NTEU's position that calculations by the Joint Tax Committee, Congressional Budget Office (CBO) and OMB to "score" the revenue impact of the private debt collection initiative were seriously flawed and should be revisited. The Joint Committee on Taxation's October 4, 2004 calculation entitled, "Budget Effects of the Conference Agreement for H.R. 4520, the 'American Jobs Creation Act of 2004' Fiscal Years 2005 – 2014," (JCX-69-04) claims that \$1.35 billion in revenues will be raised over a *ten year* period by private debt collectors at a cost of \$339 million in outlays. In other words, the government will *pay* nearly \$400 million to *possibly get* these revenues down the road.

Aside from the serious questions I have discussed about the shortcomings of the privatization proposal, it is my understanding that the Congressional Budget Office (CBO) and

others generally do not score revenue in cases in which no new tools or enforcement authority has been provided to an agency. Since the debt collectors' proposal simply allows IRS to contract with collection companies and does not provide those companies with enforcement tools, Congress should not count future revenues raised for its budgetary purposes. However, in this scoring report, \$1.35 billion over 10 years is counted. CBO does not score changes in revenues each time Congress changes funds appropriated to the IRS for staffing. Yet, by counting revenue potentially collected by debt collectors while not counting IRS's revenue raised, the committee is setting up a double standard.

It is time to stop budget gimmicks of this nature. It is clear that dollars spent on IRS compliance efforts return exponentially more to the Treasury. We must create a process that provides those dollars regardless of arcane congressional budgeting rules if we are going to make progress on closing the tax gap.

IRS Commissioner Everson has confirmed in congressional testimony that it is less costly to use IRS employees than private collection agencies. To waste taxpayer dollars in this way defies common sense and when budget scoring rules promote this waste they must be changed.

Conclusion

Frontline IRS employees are the best defense against an increasing U.S. tax gap. But it is up to Congress to provide the funding necessary for these employees to do their job. Then, it is up to the IRS to utilize these employees to their fullest potential. Without a doubt, rank and file employees are committed to working with management to increase efficiency and customer satisfaction while decreasing the U.S. tax gap.

If Congress is serious about lessening the tax gap, it will provide IRS with the necessary staffing and a dedicated funding stream to support those additional workers.

I thank you for holding this important hearing today. NTEU supports and offers assistance in your mission to shrink the U.S. tax gap.

