



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

October 7, 2015

The Honorable Ron Wyden
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Senator Wyden:

Thank you for your letter of September 2, 2015, in support of the President's Fiscal Year 2016 budget request for the IRS. I appreciate the opportunity to discuss the effect of ongoing budget cuts on cybersecurity and, more broadly, on our ability to provide America's taxpayers top quality service and apply the tax law with integrity and fairness to all. We recognize that reductions in taxpayer service and enforcement activities, as well as growing cybersecurity threats, can undermine taxpayers' confidence in the fairness and effectiveness of the tax system, and we look forward to working together to address these issues.

In your letter, you accurately describe the surge of data breaches in both the private and public sectors that lead to stolen identity refund fraud as well as the increased number of cyberattacks. You specifically ask whether diminished enforcement and reduced IT funding for the IRS should be more accurately characterized as "tax cuts for tax cheats and kickbacks to crime syndicates?"

As you note, the threat of stolen identity refund fraud and cyber-attacks against our systems poses a unique and growing challenge. We agree that ensuring the security of taxpayers' personal information is a paramount concern. This year, we were compelled to take down the online Get Transcript application that had served more than 20 million taxpayers, after criminals were able to use personal data acquired from outside sources to potentially access the historical account information of over 300,000 taxpayers.

Cyber-attacks targeting Americans' personal data for nefarious uses are rapidly increasing in frequency and sophistication. Recent attacks have hit Fortune 500 companies, financial institutions, and government agencies alike, including Target, Sony, JPMorgan Chase, and the Office of Personnel Management (OPM). The stolen identity refund fraud paradigm has shifted over recent years from small-time endeavors that sought to steal personal identities one-by-one to complex, large-scale multinational criminal enterprises stealing millions of identities through massive data breaches. To

many of these organizations, stolen identity refund fraud has become more profitable and less risky than “traditional” criminal pursuits. The proliferation of online financial and personal data has enabled an explosion in identity theft as compromised third-party data is more easily and cheaply stolen, warehoused, and sold online. Accordingly, the stolen identity refund fraud risk continues to grow in scope, complexity, and magnitude. It is more important than ever for us to make the necessary investments to protect American taxpayers from these attacks.

Private sector investments to combat cyber-threats are increasing significantly. JPMorgan Chase, for example, announced plans to double its cybersecurity budget, while Wells Fargo & Co. predicted that all companies will accelerate their cybersecurity spending by a “low- to mid-teens” percentage over the next two years. The Telecommunications Industry Association reported that private sector cybersecurity spending grew at 11.2 percent in 2012, accelerated to 14.5 percent in 2013, and is expected to exceed 15 percent growth in 2015—eclipsing growth in government spending for the first time since 2009. Meanwhile, our IT budget has actually decreased in recent years, despite the fact we maintain sensitive data on hundreds of millions of American taxpayers.

Additionally, your letter notes that Congressional Appropriators have recommended spending increases for the Department of Homeland Security and OPM in response to recent cyber-attacks. You specifically ask: “Shouldn’t the resources made available to the IRS be similarly increased in response to cyber threats?”

Our ability to address the risks posed by cyber-attacks, while continuing to expand our services to taxpayers, will require new investments in authentication, monitoring, and other cybersecurity technologies. To that end, the President’s FY 2016 Budget proposes \$281 million to bolster our cybersecurity by improving detection and prevention of online data attacks through investments in advanced technology, IT infrastructure, and data analytics. This funding would also support enforcement activities, including continued criminal investigations of conspirators worldwide. We would take especially aggressive steps to fight identity theft and stolen identity refund fraud. These steps would include systems improvements and new information sharing by state and industry partners to help us detect and prevent identity theft before tax refunds are paid; major investments in victim assistance, including comprehensive taxpayer account recovery services; and increased enforcement resources to ensure that perpetrators are caught and prosecuted.

In addition to the needed investments in stolen identity refund fraud and cybersecurity, we must also maintain a robust enforcement program to address those who willfully evade their tax obligations or who attempt to commit tax fraud. These activities range from examination and document matching to collection and criminal investigation and prosecution. An appropriate level of enforcement has been difficult to maintain given our recent funding levels. Since FY 2010, the total resources available for enforcement from all sources declined by more than \$600 million (over 11 percent, or more than 18 percent, in constant dollars). As a result, total enforcement staffing has fallen by more

than 10,000, or almost 20 percent, from the end of FY 2010 to the end of FY 2014. Not surprisingly, the level of enforcement activity to combat non-compliance and tax fraud has suffered as well. In FY 2014, we conducted 339,000 fewer individual examinations than in FY 2010, and 560,000 fewer information matching cases.

In addition to deterring criminal behavior and encouraging voluntary compliance, these enforcement programs generate a substantial amount of tax revenue for the government, many times the magnitude of our budget. As you note, investments in the IRS return, on average, over \$5 for every dollar invested. Despite consecutive years of cuts, we collected over \$57 billion through enforcement activities in FY 2014. However, we estimate that we could have collected another \$6 billion last year (and \$8 billion this year) had we remained at FY 2010 staffing levels. The enforcement investments in the President's FY 2016 budget request could result in collection of another \$3.5 billion in tax revenue in future years, which could be used for other priorities, such as reducing the deficit. Moreover, enforcement programs such as these are critical not only because of the additional revenue collected from tax evaders, but also because of their indirect effect on reinforcing voluntary compliance. By increasing the risk of getting caught and reassuring honest taxpayers that bad actors will be held accountable, these enforcement activities help support the high level of voluntary compliance that is essential to the success of our nation's tax administration system. On the other hand, if confidence in the fairness of the tax administration system were to falter, we estimate that revenue collections would decline by roughly \$30 billion for each percentage point decline in the voluntary compliance rate.

Your letter also touched on the budget challenges of providing high-quality taxpayer service. Our taxpayer service programs help compliant taxpayers navigate a complicated tax code to properly understand and meet their tax obligations. These programs include general education and outreach activities, as well as personal assistance via phone, mail or walk-in service, and we are expanding our offering of digital self-service tools. However, since FY 2010, the total level of resources available from all sources to deliver taxpayer services has declined by over \$200 million (over 8 percent, or more than 15 percent in constant dollars), while the number of individual taxpayers has increased by 9 million, or 6 percent. In addition to a noticeable decline in the toll-free level of service from 74 percent in FY 2010 to 37 percent during the most recent filing season, budget constraints have also resulted in growing correspondence inventories and unacceptably long lines for face-to-face service at our Taxpayer Assistance Centers. Limited resources for both taxpayer service and IT investments have not only inhibited our ability to combat stolen identity refund fraud and assist victims, but also to deliver new online self-help services that are key to both improving the taxpayer experience and alleviating pressure on traditional taxpayer service channels.

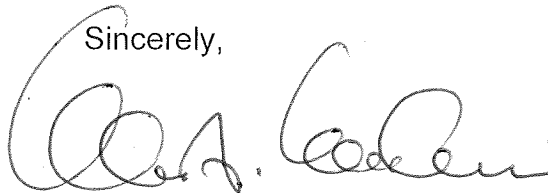
Overall, our budget has been cut by \$1.2 billion since FY 2010—a reduction of nearly 10 percent, or more than 17 percent after adjusting for inflation. In constant dollar terms, our current budget is equivalent to our funding level in FY 1998, although the size of the tax-paying population has grown by more than 9 million and we have taken on

significant new unfunded responsibilities. At the same time, as discussed above, we are confronting the growing threat of stolen identity refund fraud while strengthening cybersecurity. The combined pressures of reduced resources, new demands, and cyber threats have undermined our ability to deliver foundational taxpayer service and enforcement programs that are the twin pillars of our system of voluntary compliance.

Thank you, again, for this opportunity to discuss the effect of recent IRS budget cuts on cybersecurity, taxpayer service, enforcement activities, and for your support of the President's budget request for the IRS. With proper funding, we can meet the challenges described above, and continue to provide the services and protections that honest taxpayers deserve.

I hope this information is helpful. If you have any questions, please contact me, or a member of your staff may contact Leonard Oursler, Director, Legislative Affairs, at (202) 317-6985.

Sincerely,

A handwritten signature in dark ink, appearing to read "John A. Koskinen". The signature is fluid and cursive, with a large initial "J" and "K".

John A. Koskinen