COMMISSIONER

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

May 9, 2014

The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Senator Hatch:

I am writing to provide you with an assessment of our ability to administer certain pending provisions – qualified tax collection contracts and modification of research credit – that were marked up by the Senate Committee on Finance on April 3, 2014, as part of the EXPIRE Act. There is also considerable uncertainty related to several tax provisions that expired at the end of 2013 known as "extenders."

Each year, we conduct in-depth planning to ensure that we are prepared for all aspects of the upcoming filing season — from training our customer service employees, to modifying forms and publications, to programming our technology systems to reflect changes in the tax law. This year will be particularly challenging due to several unresolved tax issues. When the Congress takes action well after this planning process is underway, there is potential for substantial disruption to the filing season ahead.

As you further consider the tax extender legislation, I wanted to provide you with a detailed description of the impact if the Congress enacts certain provisions in the current version of the legislation, and if the current uncertainty regarding extenders continues beyond the end of this year.

Qualified Tax Collection Contracts

This provision would require the Secretary of the Treasury to enter into qualified tax collection contracts for the collection of inactive tax receivables. We must begin entering into these contracts within three months of the date of enactment. Consistent with current-law Code Section 6306, we must retain and use a portion of the collected revenues for collection enforcement activities. The provision would require that we use those revenues for compliance personnel funding.

Our scarce IT resources are currently being fully utilized in preparing IRS systems and programs for the 2015 filing season which includes ACA and FATCA implementation. We do not have the IT resources to implement this provision without diverting these resources from ACA and FATCA. Such diversion could place the 2015 filing season at risk. The 2016 filing season will also require full utilization of IT resources due to ACA and FATCA. Since diversion of IT resources results in considerable risk to the 2015 and 2016 filing season, the IRS would not be able to implement this provision for at least two years.

In addition, we would like to highlight the two previous experiences with pilot programs – those cost the IRS $8.9 million in 1996 through 1997, and $67.8 million in 2006 through 2009, for personnel and IT support funding.

In 1996 and 2006, we contracted with private collection agencies (PCAs) to work cases that the IRS would otherwise be unable to work because of limited resources. Both the IRS and independent studies concluded that, from a cost-per-dollar evaluation, PCA firms were unable to outperform IRS employees. As a steward of the American tax system, this fact weighs heavily on me.

The three year effort, between 2006 and 2009, utilizing PCAs resulted in IRS direct costs that exceeded the revenue retained and forced the agency to absorb a difference of $12.4 million out of appropriated funds. Additionally, these costs did not include startup costs for business and information technology (IT) development. Overall, the total IRS costs were $67.8 million to implement this program, resulting in a net loss of $4.4 million.

Considering the costs of prior efforts, it is important to note that if we were to deploy another PCA program, it would require that we incur significant dollars in up-front start-up costs that were not planned for nor budgeted. The IRS is the appropriate agency to collect revenues with our employees. Prior efforts required significant IRS oversight and management, quality review, and PCA contractual oversight, as well as IT resources. More importantly, the $67.8 million total costs of the 2006 effort could have been invested in an additional 700 full time equivalent (FTEs) for ACS personnel. These 700 FTEs would have produced an estimated $1.4 billion in enforcement revenue. Given the current IRS budget situation, it seems unwise to divert scare enforcement resources to fund a new program at this time.

Modification of Research Credit

This provision would expand the research and experimentation (R&E) tax credit to qualifying startup businesses, allowing such companies to claim the credit against taxes it pays on employee wages. The benefit is capped at $250,000 per year and available only to companies less than five years old with less than $5 million in gross receipts.

Expanding this credit has an impact on IRS IT resources similar to enacting a new credit. That is, it will require IT resources to change our return processing, financial accounting and compliance computer systems. We are currently devoting our scarce IT resources to implementing ACA and FATCA for the 2015 filing season. We would need to incorporate late IT requirements into the already-strained IT resource plan. In addition, we have identified abuses in the claiming of this credit on income tax returns. Having an optional credit against Federal Insurance Contributions Act (FICA) taxes adds additional complexity and further complicates our ability to identify those businesses that abuse the credit.

Health Coverage Tax Credit

As currently drafted, the IRS is not able to reinstate the administration of HCTC if this provision is enacted retroactively. The IRS relied on outside contractors for assistance with this program previously and has closed-out HCTC activities following the December 31, 2013, expiration of HCTC. Ending the HCTC program required the IRS to decommission 100 servers, close numerous contractor sites, disconnect data transmissions with the Department of Labor/Pension Benefit Guarantee Corporation, end stakeholder and health plan administrator interactions and dispose of all HCTC records, data and stakeholder collateral. After May 15, 2014, the HCTC program will no longer have access to the infrastructure, software and data needed to run the program. The IRS would require significant funding and an extended effective date (a year or longer) to reinstate administration of this program. Initial start-up costs for the HCTC were more than $69 million and additional costs would also be needed for maintenance and operations of HCTC systems for two years.

Tax Extenders

A number of other tax provisions affecting individuals also expired at the end of 2013. These include tax deductions for educators' out-of-pocket classroom expenses, tuition and related fees for higher education, and state and local sales taxes. The last provision is of particular importance to taxpayers in states with no income tax.

These tax law changes are generally not as complex and do not present anything near the operational risk associated with the above-mentioned provisions. Provided enough advance notice, the IRS could implement these provisions. On January 2, 2013, Congress enacted legislation extending these provisions retroactively. As a result, the IRS made the necessary changes to its forms and systems, and delayed the opening of the 2013 filing season for some taxpayers until late February or early March. Among the taxpayers affected were individuals claiming residential energy credits, depreciation of property, or general business credits.

If we were presented with a similar scenario of legislation containing the late enactment of unmodified tax extenders this year, I would anticipate a similar outcome.

I hope this information is helpful, and I would be happy to discuss any of these issues in more detail. I am also writing to Chairman Ron Wyden and Chairman Dave Camp and Ranking Member Sander Levin of the House Ways and Means Committee. If you have questions, please contact me, or a member of your staff can contact Leonard Oursler, Director, Legislative Affairs, at (202) 317-6985.

Sincerely,

John A. Koskinen