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

COMMISSIONER

October 17, 2011

The Honorable John Lewis
Ranking Member, Oversight Subcommittee
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Lewis:

In recent years, your committee has had an interest in IRS core operations, including our management of tax filing season, taxpayer service, and the enforcement of the nation's tax laws. I write to update you on the effects to the IRS and taxpayers if the budget cuts voted out of the House and Senate Appropriations Committees were ultimately enacted.

I recognize the fiscal challenges facing the nation and am committed to continuing to look for savings in IRS operations where we can improve efficiency without cutting into core taxpayer service and front-line enforcement. To that end, over the last several years the IRS has maintained a disciplined focus on identifying cost-effective solutions in order to maximize IRS productivity. For example, through our focused efforts to increase electronic filing of tax returns, we have cut the number of tax return processing sites in half–from ten to five. Through this effort and other targeted efficiency programs, we have generated hundreds of millions of dollars in savings.

However, cuts of the magnitude contemplated in the current appropriations bills (approximately $525 million from core IRS accounts in the Senate bill and $650 million in the House bill) would lead to noticeable degradation of both service and enforcement and would have a serious detrimental impact on voluntary compliance for years to come.

Although the current Continuing Resolution, set to expire November 18, sets funding for IRS at levels 1.5 percent below fiscal year 2011, the full-year cuts currently being contemplated are so substantial that we have no choice but to immediately reduce our spending run rate (above and beyond the aggressive efficiency initiatives already planned). The operational realities of the federal budget process do not allow us to wait for a final FY 2012 budget because if we did, we would not have enough time left in the year to make the spending cuts that could be required.

Enforcement Impact

The IRS is unique in that it has a positive return on investment to the nation's Treasury, collecting on average $2.5 trillion per year. Because our Enforcement account is 92 percent labor expenses, cutting the IRS budget by the contemplated levels would mean that front-line IRS staffing levels must be substantially reduced, leading to a measurable decrease of approximately $4 billion in revenue annually, or seven times the reduction in IRS budget. In other words, these budget cuts will result in a direct increase to the nation's deficit. We currently estimate that IRS examinations of individuals and businesses, and collection actions taken to recover known unpaid taxes would be down 5 - 8 percent.

Taxpayer Services Impact

The IRS customer service organization would be forced to dramatically cut its level of support for taxpayers. Responses to taxpayers' letters (including taxpayers who have received a notice and are trying to resolve account issues) would be delayed up to 5 months. Approximately half of the nation's taxpayers attempting to call the IRS would either be unable to get through or hang up in frustration.

While it is easy to understand the revenue implications of enforcement cuts, it is sometimes difficult for people to conceptualize the real life impact of service cuts. I thought it would be helpful to give three examples:

- A small business that fell behind on its taxes would have trouble reaching the IRS to work out a payment plan. Or, if the business paid its back taxes, it would see increased delays in getting liens released.
- An individual taxpayer who has received a notice that the IRS is about to levy the taxpayer's bank account because of unpaid taxes will have trouble getting through to an IRS representative to enter into a payment plan and forestall the levy.
- Working families, who are confronted with a complex tax code, will have trouble getting help from the IRS to receive the benefit of a tax deduction or credit that the Congress intended for them to have.

While I will try hard to minimize the degradation of our services, the additional funding required to mitigate service downgrades competes against other critically important but unfunded activities. These unfunded activities include combating growing identity theft fraud, cracking down on offshore tax evasion, processing thousands of offshore asset disclosures, and meeting new legislative requirements such as merchant card information reporting and securities basis reporting.

You and your committee have reliably supported the IRS over the past several years, so I wanted to be forthright and candid about the potential impacts of these budget actions. I intend for this letter to outline for you the operational realities and consequences of executing a budget with the reductions of the magnitude recommended by the Appropriations Committees. Of course, I respect the Congress's prerogative to set funding for the IRS as it sees fit, but higher funding levels for the IRS would also help reduce the deficit. I note that the Administration has proposed a program integrity initiative for the Joint Select Committee on Deficit Reduction's consideration.

You have my commitment that the men and women of the IRS will work hard to mitigate any damage to the tax system and will continue to serve the nation proudly.

I am also writing to the Chairman and Ranking Member of the House Ways and Means Committee (and the Chairman of the Oversight Subcommittee) and the Chairwoman and Ranking Member of the House Appropriations Financial Services Subcommittee, as well as to the Chairmen and Ranking Members of the Senate Committee on Finance and the Senate Appropriations Financial Services Subcommittee. Please call me if you would like to discuss this matter further or have your staff call Floyd Williams, Director, Legislative Affairs, at (202) 622-4725.

Sincerely,

Douglas H. Shulman