

**WRITTEN TESTIMONY OF  
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DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT  
INTERNAL REVENUE SERVICE  
BEFORE THE  
HOUSE OVERSIGHT AND GOVERNMENT REFORM COMMITTEE  
ON FINDINGS OF THE GOVERNMENT ACCOUNTABILITY OFFICE  
APRIL 13, 2016**

**INTRODUCTION**

Chairman Chaffetz, Ranking Member Cummings and Members of the Committee, thank you for the opportunity to discuss findings of the Government Accountability Office (GAO) associated with duplication, overlap, and fragmentation and opportunities for cost savings and revenue enhancement in the federal government.

While we have not been able to fully review and analyze this year's report, which is being released today, we have been working on GAO recommendations from past years on an ongoing basis and we are making steady progress on the vast majority of actions recommended. In conducting its assessment for the annual duplication, overlap and fragmentation report, GAO categorized actions relevant to the IRS as "addressed," "partially addressed," or "not addressed" based on criteria GAO defined.

While we concur with GAO and Members of this Committee that there are more actions categorized as "not addressed" than we would like, we note that the GAO report represents a snapshot partway through a long-term effort, as we continue to address the remaining areas with the resources available.

**IMPROVING INTERNAL CONTROLS AND TRACKING ACTIONS**

Internal controls are a major part of managing an organization. They comprise the plans, methods, and procedures used to meet missions, goals, and objectives; and in doing so, support performance-based management. Internal controls also serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. They help government program managers achieve desired results through effective stewardship of public resources. Systems of internal control provide reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The IRS continually works to ensure its programs and activities operate according to established policies and procedures. Tracking issues, findings, recommendations, and the current status of planned corrective actions (PCAs) resulting from annual audits is mandatory to comply with the intent of the standards of internal control. The U.S. Department of the Treasury implemented the Joint Audit Management Enterprise

System (JAMES) for use by all its bureaus to track, monitor and report the status of internal control audit results.

The information contained in JAMES is used by Treasury to assess the effectiveness and progress of bureaus in responding to material weaknesses, significant deficiencies, and remediation plans. PCAs are entered into JAMES and must be updated on or before their scheduled due date to reflect their current status. For each PCA, a description contains the details of the management corrective action or how management will implement a recommendation to address the issue and correct the weakness.

Since FY 2013, the IRS has taken actions to address more than 80 percent of the 266 recommendations proposed by GAO to the IRS according to JAMES as of March 31, 2016. Currently, 75 open items are in progress with 69 scheduled to be implemented in FY 2016 and FY 2017.

We continue to review and evaluate all of GAO's recommendations along with other outstanding recommendations in light of risk and security controls and processes currently in place. We are building corrective action plans where appropriate to address the recommendations, and we are prioritizing and addressing them as resources permit. Significant progress has been made in addressing these recommendations in areas where we are most vulnerable, and, with appropriate resources, continued progress will be made.

It is important to note that GAO's recommendations do not concern fundamental weaknesses in taxpayer-facing systems – an area of critical concern for the IRS. Rather, they concern weaknesses in our controls for internal systems – that is, systems and data that are behind our portal and firewalls. These systems have less risk of experiencing security issues because they are not connected directly to the external internet.

The IRS must also consider other factors in allocating our resources, including budget uncertainties, hiring freezes, skillset deficits, complexities associated with our antiquated legacy environment and cutbacks affecting our ability to update our infrastructure.

For the purposes of this hearing, the Committee expressed an interest in our progress addressing GAO recommendations in three areas: identify theft related refund fraud, information referral programs to report potential tax noncompliance, and the IRS Whistleblower Program.

## **IDENTITY THEFT/REFUND FRAUD**

The IRS is using a multipronged approach to protect taxpayers and their information from stolen identity/refund fraud. Discovering that your identity has been stolen by having your tax return rejected because someone else has already filed a return using

your name and Social Security Number (SSN) can be a personal, and traumatic experience. We are doing everything we can to protect taxpayers from this situation. The problem of personal data being used to file fraudulent tax returns and illegally obtain refunds exploded from 2010 to 2012, and for a time overwhelmed private industry, law enforcement, and government agencies like the IRS. Since then, the IRS has made this area a high priority and has been making steady progress within our reduced resources, both in terms of protecting against fraudulent refund claims and criminally prosecuting those who engage in this crime.

Thanks to the work of our Criminal Investigation division, about 2,000 individuals have been convicted on federal charges related to refund fraud involving identity theft over the past few years. We currently have about 1,700 open investigations being worked by more than 400 IRS criminal investigators.

Meanwhile, we continue to improve our efforts at stopping fraudulent refunds from going out the door. For example, we have improved the filters that help us spot suspicious returns before they can be processed. Using those filters, we stopped 1.4 million returns last year that were confirmed to have been filed by identity thieves. By stopping those returns, we kept criminals from collecting about \$8.7 billion in fraudulent refunds.

Importantly, the IRS also continues to help taxpayers who have been victims of identity theft. Last year, the IRS worked with victims to close more than 700,000 such cases. We have stopped many individuals from participating in these crimes, but we find that the type of criminal we are dealing with has changed. This problem has become more than just random individuals stealing personal information, with each one filing a few dozen or maybe a few hundred false tax returns at a time. We are dealing more and more with organized crime syndicates here and in other countries.

### **Security Summit Group**

To improve our efforts against this complex and evolving threat, the IRS held a sit-down meeting in March 2015 with the leaders of the electronic tax industry, the software industry and the states to create a partnership to deal with this issue together. We agreed to build on our cooperative efforts of the past to find new ways to leverage a new, public-private partnership to help battle stolen identity refund fraud. Motivating us was the understanding that no single organization can fight this type of fraud alone.

This meeting led to the development of the Security Summit group, an unprecedented partnership between private industry, state governments and IRS that has focused our joint efforts on making sure the tax filing experience would be safer and more secure for taxpayers in 2016 and beyond. This is an important step for taxpayers and for tax administration, because the critical work being done by this group is giving everyone involved a better defense against stolen identity refund fraud.

Over the past year, the Security Summit group has made progress on a number of initiatives helping taxpayers and the tax system for the current filing season. They include the following:

- Summit group members identified and agreed to share 20 data components from tax returns to improve fraud detection and prevention this filing season. For example, group members are sharing computer device identification data tied to the return's origin, as well as the improper or repetitive use of the numbers that identify the Internet "address" from where the return originates.
- Tax software providers agreed to enhance identity requirements and strengthen validation procedures for new and returning customers to protect against account takeover by criminals. This change is one of the most visible to taxpayers during the 2016 filing season, because it includes new verification procedures they need to follow to log in to their accounts. These actions will serve as the baseline for ongoing discussions and additional enhancements for the 2017 filing season.
- The Summit group created a new memorandum of understanding (MOU) regarding roles, responsibilities and information sharing pathways currently in circulation with states and industry. So far, 40 state departments of revenue and 21 tax industry members have signed the MOU, along with the IRS and endorsing organizations.
- Tax industry participants have aligned with the IRS and the states under the National Institute of Standards and Technology (NIST) Cybersecurity Framework to promote the protection of information technology infrastructure. The IRS and states currently operate under the Framework, as do many in the tax industry. Next steps in this area include follow-up sessions to develop strategy for how organizations within the tax industry can understand and use the Cybersecurity Framework. Recent reports of attempts by criminals to access private sector return preparers have highlighted the importance of this work.
- Summit group members agreed on the need to create an Information Sharing and Analysis Center (ISAC) to centralize, standardize, and enhance data compilation and analysis to facilitate sharing actionable data and information.
- Recognizing the critical role that the nation's tax professionals play within the tax industry in both the federal and state arenas, the Summit group created a team that will examine issues related to return preparers, such as how the preparer community can help prevent identity theft and refund fraud.

Our collaborative efforts are already showing concrete results this filing season. For example, Security Summit partners have helped the IRS improve its ability to spot potentially false returns before they are processed and thus before a possibly fraudulent refund is issued. Under our industry leads program, Security Summit partners and other external stakeholders such as banks provide information that allows us to improve our fraud filters, which in turn leads to more suspicious returns being identified for further

review. In Calendar Year (CY) 2016 through mid-March, leads from industry partners directly resulted in the suspension of 27,000 returns on which a total of \$119 million in refunds was claimed, up from 8,000 returns claiming \$57 million during the same period last year.

Of the additional funding for the IRS approved by Congress for FY 2016, we are using approximately \$6.1 million to invest in a number of activities that arise from the ongoing collaborative efforts with our Security Summit group partners. This includes funding the startup costs for the ISAC.

We have also centralized our assistance programs for taxpayers who are the victims of identity theft refund fraud. As a result, our inventory of cases in this area has dropped from over 60,000 in January 2015, to under 40,000 as of January 31, 2016. The average time for resolving most cases is now within our goal of no more than 120 days.

### **Identity Theft Public Awareness Campaign**

Despite the progress being made against stolen identity refund fraud, we came to realize that we were missing an important partner in this effort – the taxpaying public. So in November 2015, with the strong support of all the Security Summit partners, we launched the “Taxes, Security, Together” campaign to raise awareness about actions people can take to protect themselves and avoid becoming victims of identity theft.

Many of the steps we are talking about are basic common sense, but given that 150 million households file tax returns every year, we believe these steps cannot be stressed enough. People continue to fall prey to clever cybercriminals who trick them into giving up SSNs, bank account numbers, password information or other sensitive personal data. So having the public’s help will greatly strengthen and improve the new tools we have to stop the crime of identity theft.

As part of this public awareness campaign, the IRS in the weeks leading up to the 2016 filing season issued weekly tax tips describing the actions people could take to protect their data. We have updated several publications for taxpayers and tax professionals. We have posted YouTube videos on this subject, and public-awareness information is being shared online across IRS.gov, state websites and platforms used by the tax software industry and many others in the private-sector tax community.

Our efforts to educate and inform members of the public about the need to protect themselves against identity thieves extend to businesses as well. Information returns, especially Forms W-2, are becoming a major target of these criminals, as they seek new sources of information that will help them file false returns that have a better chance of going undetected by our fraud filters. In this effort, they attempt to trick companies into providing the information returns.

One scheme uncovered recently involved identity thieves posing as a company’s chief executive and sending a legitimate-looking request via email to the payroll department

for a list of all company employees and the Form W-2 information for each one. In March, the IRS issued an alert to payroll and human resources professionals warning them about this scam.

Identity thieves' efforts to obtain Forms W-2 have not stopped there. We are increasingly concerned about efforts to create counterfeit Forms W-2s that are filed along with the false returns to make the return appear legitimate. That concern led the IRS to launch a pilot program earlier this year testing the idea of adding a verification code to Forms W-2 that would verify the integrity of Form W-2 data being submitted.

For this pilot, the IRS partnered with four major payroll service providers. These providers added a special coded number on approximately 2 million individual Forms W-2 in a new box on the Form W-2 labeled "Verification Code." Each coded number is calculated based on a formula and key provided by the IRS, using data from the Form W-2 itself, so that each number generated was known only to the IRS, the payroll service provider, and the individual who received the Form W-2. The verification code cannot be reverse engineered. Since this identifier is unique, any changes to the Form W-2 information provided when filed are detected by the IRS. Individuals whose Forms W-2 were affected by the pilot and who used tax software to prepare their return entered the code when prompted to by the software program. The IRS plans to increase the scope of this pilot for the 2017 filing season by expanding the number and types of Form W-2 issuers involved in the test.

## **INFORMATION REFERRAL PROGRAMS**

Information referrals are a key mechanism for the public to report potential tax noncompliance to the IRS, and this information has the potential to assist the IRS in identifying tax revenue that may otherwise go uncollected. Currently, the IRS has several avenues in which alleged tax noncompliance by individuals and businesses can be reported. Our specialized information referral programs include identity theft, misconduct by tax return preparers, abusive tax promotions and wrongdoing by tax exempt organizations. Individuals submitting these referrals can do so anonymously, and this process operates outside of our Whistleblower Program (which is for individuals who are seeking a financial reward).

The information referrals that we receive go through a review and screening process to determine the usability of the information submitted, culling out information that is erroneous, vague or otherwise not actionable. As noted in GAO-16-155, in fiscal years 2012 through 2015, approximately 7 percent of information referrals routed to our operating divisions led to audits, which is a rate that is significantly higher than our overall audit rate of less than 1 percent. The audits generated based on those referrals yielded over \$209 million in additional tax assessments recommended. What these figures reveal is that our screening process is effectively identifying the productive referrals for audit, and these referrals are making an important contribution to tax administration.

In its report, GAO identified several opportunities for improvement of our information referral process; and recommended that we evaluate an organizational structure that would improve the overall effectiveness of the process, bringing about efficiency gains and improved management and oversight of our various referral programs. We appreciate GAO's insight on our referral programs, and in response, we have established a cross-functional working group that is tasked with taking into account GAO's findings to develop a streamlined, coordinated and efficient process with appropriate internal controls for managing this important tax program. We will also be exploring the feasibility of using a single form for the reporting of referral information, as well as considering whether and when we could offer a secure online option for the submission of this information to IRS.

## **IRS WHISTLEBLOWER PROGRAM**

Information received from tax whistleblowers - individuals who report to the IRS on violations of tax laws by others - is an important tool for improving tax administration, and has assisted the IRS in detecting tax compliance issues and in collecting over \$3 billion dollars in tax revenue. Since 2007, the IRS has awarded more than \$403 million to whistleblowers.

It is without question that the Whistleblower Program makes an important contribution to the tax system, both by helping encourage compliance (through a deterrent effect on those who may otherwise engage in tax evasion or avoidance) and by reducing the Tax Gap (through submissions of valuable information that has resulted in a wide range of audits and investigations, and yielded significant collection of unpaid taxes). We are committed to maximizing the success of this program. Although staffing across the agency has been declining, the staffing for our Whistleblower Office has not incurred staffing reductions, but has grown significantly since the inception of the office in 2007.

We appreciate GAO's robust review of this IRS Program. The inefficiencies that GAO identified with the whistleblower claim process are ones that we had previously identified, and they are part of what led us to take action to strengthen this program. The report findings further confirm the existence of efficiency improvement opportunities. GAO's recommendations are timely and insightful and will assist us in making progress in our re-engineering of the whistleblower claim process.

To date, we have initiated the following actions, both to address the backlog of whistleblower claims that resulted from the existing claim process and to design the future process to be efficient and effective, while improving the timeliness of the claim process :

- To deal with the whistleblower claims backlog, we brought in employees from other divisions to work the inventory. The classification inventory, which peaked at 5,703 claims in March 2015, is down to a total of 865 claims requiring classification as of March 31, 2016. We also added six employees to the Whistleblower Office to work the award determination backlog, and we have

eliminated the denial and rejection letter backlogs in the Initial Claims Evaluation unit;

- We initiated a Lean Six Sigma (LSS) project in the Fall of 2014 that has been looking at ways to streamline operating processes by eliminating the multiple hand-offs between the Whistleblower Office and the operating divisions, and to provide opportunities for efficiencies in managing whistleblower claims, including technology improvements;
- Since last year, a senior executive from the Deputy Commissioner for Services and Enforcement's Office has been assigned to guide the Whistleblower Program re-engineering effort; and
- In August of 2015, Lee Martin assumed responsibility for directing the Whistleblower Program, bringing with him a strong background in LSS and organizational effectiveness. Once the LSS provides its recommendations and the new Whistleblower Office Director has an opportunity to complete his assessment, we will pursue full process improvement implementation.
- We have proposed statutory changes "to amend section 7623 to explicitly protect whistleblowers from retaliatory actions, consistent with the protections currently available to whistleblowers under the False Claims Act" and to "amend section 6103 to provide that the section 6103(p) safeguarding requirements apply to whistleblowers and their legal representatives who receive tax return information in whistleblower administrative proceedings and extend the penalties for unauthorized inspections and disclosures of tax return information to whistleblowers and their legal representatives."

The report from GAO also covered the issue of Whistleblower Office communications, both with whistleblowers directly and more broadly through the whistleblower annual report to Congress. With respect to communications with whistleblowers, we appreciate that whistleblowers would like to hear from IRS on the status of their claim. However, as noted in the report, section 6103 of the Code prohibits us from disclosing tax information. For example, whistleblowers often want to know whether we are auditing the taxpayer that they identified; however, we cannot disclose that information because confirming that a taxpayer is under audit would be revealing personal taxpayer information.

In an effort to address whistleblowers' communication concerns, we conducted a pilot whereby we sent letters to whistleblowers informing them that their claim is open and still under consideration. We are evaluating the results of that pilot, and will consider GAO's insights as we formulate our path going forward. We are also looking into situations where entering into a contract under section 6103(n) would be useful to the examination process while ensuring that there is no risk of tainting the audit. Likewise, we appreciate GAO's recommendations for our annual report to Congress. The most recent annual report for FY 2015, released on February 9, 2016, reflected meaningful changes with respect to content, format, and timing.



Finally, we recognize the importance of updating the policies and procedures of the Whistleblower Program, and all programs, for that matter. As we implement GAO's recommendations, as well as the changes from the LSS project, we will ensure that our policies and procedures are updated in a timely fashion and we will strengthen our internal controls. These are important oversight functions and they will be the focus of the Whistleblower Office.

## **REDUCED RESOURCES LIMIT PROGRESS**

We appreciate the GAO's recognition of the work that the IRS has done and continues to do in an era of formidable budgetary challenges that have resulted in reduced resources and staffing.

We also appreciate that the Congress, including the members of this Committee, approved \$290 million in additional funding for the IRS for FY 2016, to improve service to taxpayers, strengthen cybersecurity, and expand our ability to address refund fraud and identity theft. This brings total IRS appropriations for FY 2016 to \$11.2 billion. This additional funding was an important development for the IRS and for taxpayers, and is the first time in six years that the agency has received significant additional funding. It is a major step in the right direction, and I can assure the Congress that we will use these resources wisely and efficiently.

Even with this additional funding, however, the IRS is still under significant financial constraints. This is illustrated by the fact that the IRS appropriation remains \$900 million below the FY 2010 enacted level and that the \$290 million increase is less than half the amount that had been requested in FY 2016 for the three critical areas mentioned above. In addition, the IRS must absorb mandated cost increases and inflation during FY 2016 that are greater than the additional funding provided. Therefore, this year we have to continue the exception-only hiring policy that began in FY 2011, leaving us unable to replace most employees we lose this year through attrition. Thus, although we will be undertaking additional seasonal and temporary hiring to improve our telephone level of service (LOS), we expect the permanent IRS workforce to continue to shrink by another 2,000 to 3,000 full-time employees during FY 2016, equaling a loss of over 17,000 full-time employees since FY 2010.

The President's FY 2017 Budget proposal for the IRS, described in more detail in written testimony provided earlier this year to congressional appropriators, requests a base funding increase of \$530 million above the FY 2016 enacted level. This would support improvements to a wide range of taxpayer service activities and would provide \$90 million in additional funding to help prevent identity theft and refund fraud and to reduce improper payments. This funding will increase the capacity of our most important programs, such as fraud referrals (discussed above), and will allow us to close almost 100,000 additional identity theft cases per year by helping victimized taxpayers who have engaged the IRS for assistance.

The Budget also proposes a multi-year program integrity cap adjustment for to restore and improve tax enforcement activities, including \$515 million in FY 2017 to reduce the deficit and narrow the tax gap. If approved, the cap adjustment would yield an estimated net taxpayer savings of \$46 billion over the next 10 years in direct revenue.

The IRS plays a significant role for the government, especially in the area of revenue enhancement. It is estimated that a one-percent drop in the compliance rate results in a revenue loss of approximately \$30 billion per year, or \$300 billion over the 10-year budget window. As such, we believe that it is extremely important to help taxpayers easily comply with their tax obligations, and to maintain a strong deterrent effect against non-compliance through diligent enforcement.

We continue to recognize the importance of spending taxpayer dollars wisely and working to strengthen our operations as we move forward.

## **CONCLUSION**

The IRS is taking meaningful steps toward addressing areas of duplication, fragmentation and overlap, consistent with government-wide guidance and standards. Without waiting for many solutions to be fully funded, we have begun to take action using the resources available to us.

Chairman Chaffetz, Ranking Member Cummings and Members of the Committee, this concludes my statement. I would be happy to take your questions.



**JOHN M DALRYMPLE**

John M. Dalrymple is the Deputy Commissioner for Services and Enforcement. He provides direction to the four taxpayer-focused IRS operating divisions, including Wage and Investment; Large Business & International; Small Business/Self-Employed and Tax Exempt and Government Entities. He also oversees the IRS Criminal Investigation Division, Office of Professional Responsibility, Online Services, the Return Preparer Office and IRS Whistleblower Office.

Mr. Dalrymple has 32 years experience working at the IRS, including 14 years in the Senior Executive Service. He previously served as IRS Deputy Commissioner for Operations Support from 2003 to 2006. Following his retirement from the IRS in 2006, he became a Director at Deloitte Consulting. During his IRS career, Mr. Dalrymple's experience covered a variety of enforcement, taxpayer service and support positions. He served as Commissioner of Wage and Investment from 2000 to 2003. He was IRS Chief Operations Officer from 1996 to 2000, and he was a District Director in the IRS North Central District from 1995 to 1996.

He began his career with the IRS as a revenue officer in 1975 and has held management positions in several IRS district offices. Mr. Dalrymple is a graduate of the University of Northern Iowa.

The IRS Deputy Commissioner for Services and Enforcement is a career civil service position. The position, along with the Deputy Commissioner for Operations Support, reports directly to the IRS Commissioner.