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Prepared Remarks of IRS Commissioner Doug Shulman at the National Press Club

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WASHINGTON — Thank you for that gracious welcome… and thank you for inviting me back to the National Press Club.

A few weeks back, I celebrated my third year as IRS Commissioner. And milestones like this allow us to pause and reflect on how far we've come…what we've accomplished… what we've learned…and what lies ahead.

It's certainly been an interesting journey so far. Some things I expected, and others I didn't. One of the most pleasant surprises… and yes, there are pleasant surprises being IRS Commissioner…was that this large organization was so responsive…so agile… and so nimble.

The IRS literally turned on a dime during the worst economic downturn in a generation, when we were called upon to help millions of taxpayers in distress. We sent out hundreds of billions of dollars to help jump start the economy, as we were called on to play a part in the nation's economic recovery.

Together we've accomplished much over these past three years… from improving service to taxpayers… to cracking down on offshore tax abuse… to launching our initiative to work with the tax return preparer industry to boost compliance and help taxpayers get it right from the start.

And I have certainly learned a great deal … and that's a process that never stops.

I've learned much about the inner workings of our tax system and what we expect of taxpayers…and just as importantly…what they expect of us.

So, this strikes me as the right moment to open the aperture wide to capture all that's happening in our changing and dynamic tax system.

It's the right moment to take a view of our tax system that takes us to its very horizon.

Microsoft co-founder Paul Allen once observed, "I've tried to anticipate what's coming over the horizon, to hasten its arrival, and to apply it to people's lives in a meaningful way."

That's basically what I would like to do today… to look to the horizon to see what we could do to make a meaningful difference in both our tax system and taxpayers' lives…and start a dialogue about how we can secure lasting change.

Ever since I became Commissioner, I have made it one of my top priorities to put the IRS on a path of continuous improvement... to evolve …to get better. I believe we should perform the best we can today, while embracing change, so that we can perform even better in the future.

But looking to the future doesn't mean we have to be futuristic, like some fantasy "world of tomorrow" you would see in a science fiction film. Looking forward is challenging ourselves individually and collectively to see how far we can go…how much of an impact can we make…and how confidently we can move into the future. As President Kennedy once said, "I'm an idealist without illusions."

In a bit of irony, I'm here to tell you that for the IRS to look forward, our first step is to examine what has been woven into the IRS' DNA since its inception in 1862 – "looking back" as a business model.

While a significant percentage of our resources is devoted to helping taxpayers understand the tax law, the compliance side of our operations is largely predicated on looking back. A taxpayer prepares his or her return and e-files it, or sends it to us by mail. We process it and issue a refund if the taxpayer is owed one, or deposit the taxpayer's check or credit card payment for any taxes owed the government.

For most taxpayers the process ends there. But for the IRS, our compliance work now begins. Sophisticated risk models help IRS staff identify returns that are most likely to show compliance problems. Although I sometimes hear people refer to the IRS "audit lottery," the process is far from random. The IRS uses the cumulative knowledge and data over many years to model the risk of tax avoidance, and using these models we target our activities as precisely as we can. We then follow up with the taxpayer to better understand the issue, request documentation, and determine whether the return was accurate.

The "look-back," which is the model of most major tax systems in the world, has some flaws. The biggest deficiency is that it does not deal with taxpayer problems up-front.

An IRS audit often occurs years after the return was filed. For example, by law we have up to three years to audit an individual's tax return; more time if there's a 25 percent or more omission of income, or if fraud is involved. As I speak now, we may still be looking at returns filed in 2008. That's right… some taxpayers are interacting with the IRS about returns that were filed around the time I was sworn in as Commissioner.

This after-the-fact compliance approach can create problems and frustrations for both taxpayers and the IRS.

It can be a real dilemma for taxpayers, who may no longer have the money that was refunded to them, but it turns out, they were not entitled to. There's also possible sticker shock because interest and perhaps penalties may have been accruing on any tax due for up to three years. Taxpayers ask, "Why didn't you notify me earlier?" This hurts the IRS' image and contributes to a "gotcha" perception.

As we all know, it’s much easier and cheaper to resolve a problem up-front than let it fester. That’s why consumers often get a call from a credit card company within days after missing a payment due date. Although no one likes these calls, taxpayers rightly wonder why they can’t receive the same timely response from the IRS and not get stuck down the road with interest and penalties. I’ve spent a lot of time thinking about that too.

That is why we’ve been accelerating our programs so that we flag issues up front, and avoid the “look-back” problem altogether. We have increased our compliance activities that happen up-front, before we finish processing the returns. Most of the innovation has occurred in our unit that analyzes tax returns that claim a substantial tax refund.

Our systems sift through millions of returns and billions of data points to identify questionable returns, such as those fraudulently claiming refundable tax credits. Increasingly, we are also consulting other databases to spot inconsistencies on the return. As a result of our efforts, we block billions of dollars of refund claims before they are paid out so that we can verify the accuracy of the claim.

In some cases, the taxpayer simply forgot to attach the required documentation. In that instance, once sufficient information is provided, the refund is issued. In other cases, the claims are fraudulent, often part of organized rings of tax cheats, sometimes even run out of prisons. Our success rate in blocking these claims is very high and only getting better as we improve our capabilities, and stay ahead of the schemes.

As we think about the future and ways that we can more aggressively move to resolving issues right up-front at the time of filing, a number of complicated issues arise. Many of them involve information returns that the IRS receives every filing season. You probably know these information returns by their Form numbers – the W-2 and 1099, just to name a couple. To give you some perspective, 40 years ago, we received about 360 million information return documents a year. Today, it is over two billion.

Just think of a typical taxpayer who works in an office or store and owns his or her home. He or she has the ubiquitous W-2, but also information returns for mortgage interest, interest and dividend distributions from their bank, credit union, mutual funds and other securities. There may even be a K-1 thrown in. On average, a taxpayer receives 10-15 information returns each year.

Of course, these information returns foster voluntary compliance, since they are filed with the IRS. But it is often overlooked what a real timesaver they can be for taxpayers. Indeed, without the standardized formatting and data elements of the information returns, today’s robust tax software industry would be many years behind.

Now, let’s peek behind the curtain and see what this looks like for the IRS. First, in many cases, we receive information returns after a taxpayer files their tax return. We then go through a lengthy process of collating and matching all these documents to the taxpayer’s return, which can be further complicated if it’s a joint return where we then have to marry John and Mary Doe’s information to one return.

While these information returns have made our tax system light years more efficient than it used to be, I believe they are also the source of the next generation of innovation.

And that's what I want to elaborate on today: a potential new structure of tax administration … a structure of opportunity …and a fundamentally different way to run our tax system.

In essence, I believe taxpayers, third parties in the tax system, and the government would be better served if we moved our processes forward and reduced the need for after-the-fact look-backs as a mode of operation.

The vision is relatively straightforward. The IRS would get all information returns from third parties (W2s, 1099s, etc) *before* individual taxpayers filed their returns. Taxpayers or their professional return preparers could then access that information, via the Web, and download it into their returns, using commercial tax software. Taxpayers would then add any self-reported and supplemental information to their returns, and file the returns with us. We would embed this core third-party information into our pre-screening filters, and would immediately reject any return that did not match up with our records. That's right; we reject the return and ask you to fix it *before* we process it. We would then have more accurate returns and deal with many more problems up-front. We could shift resources to spend more money getting it right in the first place, and do less back-end auditing.

That vision is easier articulated than executed and could not be pulled off overnight. And in order to execute it, there would need to be some fundamental changes in both our operation and private sector processes. Let me talk for a minute about what would have to change as a prerequisite to moving in this kind of a direction.

First, it would take a major reworking of some of our fundamental technology systems. I will tell you that we could not have even thought about this a few years back, before we were on a solid path to complete our core customer account database, which we call CADE 2. Over the past few years, we have been working to get all of our individual taxpayer accounts in a database that processes on a daily basis, rather than weekly or bi-weekly. This new database will allow all taxpayers to receive faster refunds and will eliminate structural technology problems that could lead to timing problems with notices sent to taxpayers.

But, even once this is done, we would have a lot of work to do in the technology area. We would need to load and be ready to run matches with all of the W-2 data we receive from the Social Security Administration months sooner than we do so now. We would also have to load all 1099 data in our systems before returns are filed. And, we would need to be able to match in real-time these 1099 and other documents with returns being filed. Again, this is much easier said than done given budget constraints and real production issues we face during our peak filing season between January and April.

Performing a major technology enhancement to the systems that process approximately $2.5 trillion in annual revenues is a highly complex endeavor, and to be blunt, is not cheap. But we are making an investment in our technology infrastructure – like CADE 2 – to set the stage for the future.

In all honesty, there was an under-investment in IRS technology over the past 20 years which left us in a very deep hole. Starting with the President's 2011 budget proposals the trend has been reversed. But, given the current budget debates in Congress, we will have to see if we get the resources we need to build the basic technology infrastructure needed for the future.

In order to execute a more real-time tax system, we would also need to push to get information returns, like 1099s, into the system earlier. This would require some change of behavior on the private sector's part. Our partners, whether they are payroll processors or practitioners, would need to work with us to make the dates work in a way that works for the American people. Dates like February 28, the due date for 1099 returns, are built into the core operations of both the IRS and the tax community. If we wanted to move to an up-front, more real-time tax system, traditional timelines would need to be on the table for discussion.

The vision I'm articulating is a potential win-win for honest taxpayers and our government. It streamlines the tax return process for the vast majority of people who play by the rules and want to get it right.

It also minimizes interactions with the IRS… which is what most taxpayers want.

As I described earlier, this would not only change the face of taxpayer service but also compliance. Unlike today's look-back, we would do a 180 degree turn and most basic compliance activities would be done up-front, and we would reject a return right away if a problem was detected.

And here's a simple illustration of a real world common problem we encounter today and how we would fix it.

A taxpayer mistakenly enters $2,000 in dividends on his return. However, from the taxpayer's 1099s, we show the dividends to be $3,500. Because of this mismatch, the IRS must follow up with the taxpayer well after the return is filed to address the unreported income.

Under the structure I envision, this situation simply wouldn't occur. A taxpayer would begin the filing process with access to all the information that has been reported to the IRS. Any discrepancies that taxpayers see between the information as reported to the IRS, and their own records could be resolved *before* filing the tax return, when the records are fresh ... and also fresh in their mind. Taxpayers get it right the first time, with no risk of getting a letter about the mismatch later…and no risk of interest and penalties.

The better use of information and data has long been a priority of mine. The payoffs are huge. Taxpayers avoid the hassle factor and back-end audits are much more focused on issues that require follow-up. We would see significant gains in both service and compliance that have the potential of saving billions of dollars across the public and private sectors in reduced administrative burden.

Now, some people, including me, have wondered if letting taxpayers know what we know would reduce compliance. I think there are two responses to this question.

First, of course, there will still be a need for audits and other types of after-the-fact compliance work to make sure that our overall level of voluntary compliance remains high.

Second, I chair an organization comprised of the tax commissioners around the world. Many countries now make the information they have available to taxpayers, and none have reported a drop in compliance.

So where do we go from here? First of all, at this early juncture, I don't see this as a plan or blueprint with proposed structures, timelines and deliverables.

What I'm offering is a vision for a journey that's firmly grounded in reality but brims with potential.

I can't tell you when this will happen, but I don't think it's too soon to start a dialogue on the vision and engage the business community. It's certainly not too soon to start scoping the technology work that we would need to undertake to help us make the next big leap …a generational leap… in how our tax system fundamentally works.

And this is all about working smarter… a theme of mine too since I became Commissioner. In the case of the IRS, it means evolving to keep pace with change, constantly looking ahead, and being innovative and more imaginative with available resources inside and outside the agency.

I think we are now at the point where we can lift our heads above the daily and weekly fray, and begin a dialogue about a shift in the tax structure. As our new customer account data engine goes online, we will have a key foundation for this. As our e-file rate went above 70 percent for the first time last filing season, we also now have information coming to us in a digital format, which is a prerequisite to quicker population of our databases and systems.

And modern technology can now move in real-time, and process large amounts of information exponentially faster than just a decade ago. So, both internal and external factors make the time ripe to think big, and broad and long-term.

So let me wrap up by saying that this is not a plan…but it's not just a dream either. What I've described today – a vision for a more real-time tax system for the nation – is real and doable. It is something we will discuss with affected stakeholders and our internal team. My goal is to keep pushing the agency to imagine the future and make the tax system work better for the American people.

So let me leave you today with some final words that Franklin Delano Roosevelt wrote shortly before his passing in April 1945 for a speech he would never deliver: "The only limit to our realization of tomorrow will be our doubts of today." Thank you for listening and I would be happy to take some questions.

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