

## THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS: Introduction

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2014, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 23 such problems.

As in earlier years, this report discusses at least 20 of the most serious problems encountered by taxpayers—but not necessarily *the top 20* most serious problems. That is by design. Since there is no objective way to select the 20 most serious problems, we consider a variety of factors when making this determination. Moreover, while we carefully rank each year's problems under the same methodology (described immediately below), the list remains inherently subjective in many respects.

To simply report on the top 20 problems would limit our effectiveness in focusing congressional, IRS, and public attention on critical issues. It would require us to repeat much of the same data and propose many of the same solutions year to year. Thus, the statute gives the National Taxpayer Advocate flexibility in selecting both the subject matter and the number of topics to be discussed and to use the report to put forth actionable and specific solutions instead of mere criticism and complaints.

### METHODOLOGY OF THE MOST SERIOUS PROBLEM LIST

The National Taxpayer Advocate considers a number of factors in identifying, evaluating, and ranking the most serious problems encountered by taxpayers. In many years, the National Taxpayer Advocate identifies a theme for the report that is reflected in the selection of issues. For example, this year the theme is *what the IRS must do to enhance the remedies available to taxpayers under the Taxpayer Bill of Rights*.

The 23 issues in this year's report are ranked according to the following criteria:

- Impact on taxpayer rights;
- Number of taxpayers affected;
- Interest, sensitivity, and visibility to the National Taxpayer Advocate, Congress, and other external stakeholders;
- Barriers these problems present to tax law compliance, including cost, time, and burden;
- The revenue impact of noncompliance; and
- Taxpayer Advocate Management Information System (TAMIS) and Systemic Advocacy Management System (SAMS) data.

Finally, the National Taxpayer Advocate and the Office of Systemic Advocacy examine the results of the ranking on the remaining issues and adjust it where editorial or numeric considerations warrant a particular placement or grouping.

### TAXPAYER ADVOCATE MANAGEMENT INFORMATION SYSTEM (TAMIS) LIST

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC, but TAS's integrated approach to advocacy—using individual cases as a means for detecting trends and identifying systemic problems in IRS policy and procedures or the Code. TAS tracks individual taxpayer cases on TAMIS. The top 25 case issues, listed in Appendix 1, reflect TAMIS receipts based on taxpayer contacts in fiscal year 2014, a period spanning October 1, 2013, through September 30, 2014.

## USE OF EXAMPLES

The examples presented in this report illustrate issues raised in cases handled by TAS. To comply with IRC § 6103, which generally requires the IRS to keep taxpayers' returns and return information confidential, the details of the fact patterns have been changed. In some instances, the taxpayer has provided written consent for the National Taxpayer Advocate to use facts specific to that taxpayer's case. These exceptions are noted in footnotes to the examples.

## MSP #1 **TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers**

### DEFINITION OF PROBLEM

The most serious problem facing U.S. taxpayers is the declining quality of service provided to them by the IRS when they seek to comply with their federal tax filing and payment obligations. The deficiencies in taxpayer service have been on our “Most Serious Problems” list for several years. As we begin 2015, the widening imbalance between the IRS’s increasing workload and its shrinking resources leads us to designate it the #1 problem for taxpayers.

More than 100 million taxpayers attempt to reach the IRS by telephone each year. For fiscal year (FY) 2015, the IRS is projecting it will only be able to answer about 50 percent of the calls it receives from taxpayers seeking to speak with a telephone assistor, and it projects that those taxpayers who manage to get through “could easily wait 30 minutes or more for limited service.”<sup>1</sup> If these projections prove accurate, taxpayers in 2015 will receive the worst levels of service since the IRS implemented its current performance measures in 2001.<sup>2</sup> For comparison, the IRS’s best year was 2004, when it answered 87 percent of its calls, and taxpayers had to wait only about 2½ minutes on hold.<sup>3</sup> To make matters worse, the IRS last year decided it would answer only what it terms “basic” questions, declaring “more complex” questions that it previously answered “out of scope.”<sup>4</sup> Therefore, even when a taxpayer manages to get through to a telephone assistor with a question, the assistor may not be able to provide an answer.

Millions more taxpayers visit the IRS’s walk-in sites every year. The same limitations on the scope of tax-law questions imposed on the phone lines were also imposed at the walk-in sites.<sup>5</sup> In addition, the IRS last year discontinued its long-time practice of preparing tax returns for hundreds of thousands of low income, elderly, and disabled taxpayers who sought assistance.<sup>6</sup> Overall, the IRS is providing more limited services to fewer taxpayers who face increasing difficulty obtaining those services, compared to just two years ago.

The lack of adequate taxpayer service stands in marked contrast to congressional directives and the IRS’s own stated goal. In 1998, Congress directed the IRS to revise its mission statement, which at that time emphasized revenue collection, “to place a greater emphasis on serving the public and meeting taxpayers’ needs.”<sup>7</sup> In response, the IRS adopted a new mission statement, stating that the IRS’s mission is to

1 Email from Commissioner Koskinen to all employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014).

2 For data going back to FY 2001, see in combination IRS, FY 2013 Enforcement and Service Results 9, at <http://www.irs.gov/PUP/newsroom/FY%202013%20Enforcement%20and%20Service%20Results%20-%20WEB.pdf>, and IRS, FY 2006 Enforcement and Service Results 10, at [http://www.irs.gov/pub/newsroom/11-06\\_enforcement\\_stats.pdf](http://www.irs.gov/pub/newsroom/11-06_enforcement_stats.pdf).

3 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2004).

4 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

5 *Id.*

6 *Id.*

7 Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 1002, 112 Stat. 685, 690 (1998).

“provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.”<sup>8</sup>

In the National Taxpayer Advocate’s 2007, 2011, and 2013 reports to Congress, we recommended that Congress strengthen taxpayer rights protections by adopting an overarching, principles-based Taxpayer Bill of Rights.<sup>9</sup> We reiterate and expand on that recommendation in this report.<sup>10</sup> Among the rights we recommended for adoption in 2007 and 2011 was “The Right to Be Assisted,” which in our 2013 report we retitled “*The Right to Quality Service*.” In July 2013, the House of Representatives—with bipartisan support, on a voice vote, and without opposition—approved verbatim the Taxpayer Bill of Rights we recommended in 2011, including “The Right to Be Assisted.”<sup>11</sup> The Senate did not pass companion legislation, but in 2014, the IRS administratively adopted a slightly modified version of the Taxpayer Bill of Rights.<sup>12</sup> It included “*The Right to Quality Service*.”

As we enter 2015, we are deeply concerned that taxpayers are receiving markedly less assistance from the IRS now than at any time in recent history. IRS support is critical for millions of taxpayers, and its absence imposes significant burdens on taxpayers who cannot obtain timely assistance from their government. Without adequate support, many taxpayers will be frustrated, some will make potentially costly mistakes, others will incur higher compliance costs when forced to seek information and assistance from tax professionals that the IRS previously provided for free, and still others will simply give up and not file returns at all.

## ANALYSIS OF PROBLEM

### Overview

The IRS interacts with more Americans every year than any other federal government agency.<sup>13</sup> In fiscal year (FY) 2014, individuals filed nearly *150 million income tax returns*.<sup>14</sup> Even that figure understates the number of people interacting with the IRS because about 50 million returns were joint returns, and many claimed additional dependents. Business entities filed more than *10 million income tax returns*.<sup>15</sup>

8 IRS News Release IR-98-59, *New IRS Mission Statement Emphasizes Taxpayer Service* (Sept. 24, 1998), at <http://www.irs.gov/pub/irs-news/ir-98-59.pdf>.

9 National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); National Taxpayer Advocate 2011 Annual Report to Congress 493-518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); National Taxpayer Advocate 2007 Annual Report to Congress 478-89 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis “Apology” Payments*). We recommended that Congress take the multiple, existing taxpayer rights scattered throughout the Internal Revenue Code and group them into ten broad categories, modeled on the U.S. Constitution’s Bill of Rights, that would be easier for taxpayers to understand and invoke.

10 See Legislative Recommendation, *TAXPAYER RIGHTS: Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections*, *infra*.

11 Taxpayer Bill of Rights Act of 2013, H.R. 2768, 113th Cong. (sponsored by Representative Roskam and passed by the House on July 31, 2013). In addition to stating the ten core rights, the bill would have clarified that the Commissioner has a duty to ensure IRS employees are familiar with and act in accordance with those rights.

12 IRS News Release IR-2014-72, *IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be Highlighted on IRS.gov, in Publication 1* (June 10, 2014), at <http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights;-10-Provisions-to-be-Highlighted-on-IRSGov,-in-Publication-1>.

13 By comparison, 59 million Americans received Social Security benefits in 2014. See <http://www.ssa.gov/news/press/basic-fact.html>.

14 IRS Publication 6292, *Fiscal Year Return Projections for the United States 2014-2021*, at 4 (Fall 2014). About 50 million are joint returns, so the number of taxpayers is nearly 200 million. IRS Compliance Data Warehouse, *Individual Returns Transaction File* (Tax Year 2013) (showing 51.5 million joint returns filed through October 2014).

15 *Id.*

Because of the complexity of the tax code, many taxpayers or their preparers contact the IRS with questions. In addition, IRS compliance functions initiate contact with taxpayers throughout the year—usually through correspondence—and taxpayers often contact the IRS in response. All told, the IRS has received:

- More than *one hundred million telephone calls* from taxpayers in every year since 2008.<sup>16</sup>
- More than *ten million letters* a year, on average, from taxpayers responding to proposed adjustments and other notices.<sup>17</sup>
- More than *five million visits from taxpayers in the IRS's walk-in sites* each year who seek to obtain forms, ask questions, or conduct other business.<sup>18</sup>

Given that U.S. taxpayers pay the federal government's bills—and collectively paid more than \$3 trillion in taxes last year<sup>19</sup>—the National Taxpayer Advocate believes the government has a moral and practical imperative to make the tax compliance process as painless as possible. Today, we are far from that goal, and we are moving in the wrong direction.

As mentioned above, the IRS is projecting it will be able to answer only about 50 percent of the telephone calls it receives from taxpayers seeking to speak with a telephone assistor in FY 2015, and it projects that taxpayers who get through will face wait times of 30 minutes or more for limited service.<sup>20</sup>

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For taxpayers who turn to practitioners for help, the news is even grimmer. The IRS maintains a “Practitioner Priority Service” (PPS) telephone line for tax professionals calling the IRS to assist their clients with account-related issues such as audits, yet the term “priority” has become an object of derision among practitioners. Prior to the enactment of the FY 2015 budget cuts, the IRS was projecting wait times averaging more than 41 minutes on the PPS phone line.<sup>21</sup> Not only is this extraordinarily inconvenient for the hundreds of thousands of Certified Public Accountants, Enrolled Agents, and attorneys who must wait on hold, but these professionals often charge their taxpayer-clients for some or all of this time, increasing the cost of tax compliance.

The IRS's ability to meet taxpayer needs has been deteriorating for the past decade as the agency's workload has increased and its budget has declined. While no metric is perfect, the following graph illustrates these trends, using the number of returns the IRS receives as a proxy for work and the percentage of

16 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2008 through FY 2014).

17 IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2008 through FY 2014)*.

18 IRS Wage & Investment Division, *Business Performance Review 7* (4th Quarter – FY 2014, Nov. 6, 2014).

19 Government Accountability Office (GAO), GAO-15-173, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements 111* (Nov. 2014), at <http://www.gao.gov/assets/670/666863.pdf>.

20 Email from Commissioner Koskinen to all employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014).

21 IRS Wage & Investment Division, *Business Performance Review 4* (4th Quarter – FY 2014, Nov. 6, 2014). This projection was made prior to the enacted reduction in IRS funding for FY 2015. As a consequence of the funding reduction, the wait-time projections are likely to be increased.

telephone calls the IRS is able to answer from taxpayers seeking to speak with a telephone assistor (known as the “Level of Service”) as a proxy for taxpayer service.<sup>22</sup>

**FIGURE 1.1.1**

**Total tax returns, IRS budget, and telephone level of service**



In FY 2014, the IRS significantly reduced core taxpayer services it had long provided. As mentioned above, it substantially stopped answering tax-law questions from taxpayers, limiting the scope of questions it answered during the filing season ending on April 15 and answering no tax-law questions at all after that date. It also terminated its longstanding practice of preparing tax returns for certain populations of taxpayers.

With further reductions in the IRS’s budget and increasing challenges in 2015, the IRS leadership has been discussing further changes to its service delivery options. The National Taxpayer Advocate and her staff, who serve on committees discussing these contemplated changes, are deeply concerned about the long-term ability of the IRS to provide essential taxpayer services.

The causes of this unfortunate and worsening state of affairs are several:

- First, the complexity of the tax code makes tax administration far more complicated than it needs to be.
- Second, Congress has given the IRS the task of administering many social and economic benefit programs, including tax credits for low income and business taxpayers, and most recently, the Patient Protection and Affordable Care Act (ACA).<sup>23</sup> Both the ACA and the Foreign Account

22 The number of returns combines individual and business-entity returns. In this and several other workload-trend charts in this section, we omit data for FY 2008 because the data for that year was extreme and aberrational. As discussed in more detail below, the Economic Stimulus Act of 2008 caused the number of telephone calls the IRS received on its Account Management (AM) phone lines to more than double from 67 million in FY 2007 to 151 million in FY 2008, and the number of individual income tax returns to increase from 139 million in FY 2007 to 154 million in FY 2008.

23 Pub. L. No. 111-148, 124 Stat. 119 (2010).

Tax Compliance Act (FATCA),<sup>24</sup> a far-reaching compliance program, will substantially take effect during 2015.

- Third, and as described later in this section, the IRS's workload has been increasing significantly in recent years.
- Fourth, Congress has reduced the IRS's funding significantly since FY 2010. The IRS's budget has been cut by 10 percent, and we estimate the effects of inflation have reduced the agency's purchasing power by an additional 7.5 percent, effectively reducing its resources by about 17 percent overall. Among other things, these cuts have left the IRS without sufficient funds to hire enough customer service representatives to staff the phone lines, answer taxpayer correspondence, conduct taxpayer and practitioner outreach and education, and meet taxpayers' needs in its walk-in sites.

The National Taxpayer Advocate has repeatedly urged Congress to simplify the tax code,<sup>25</sup> and as a related matter, has suggested standards policymakers may use in evaluating which social and economic benefit programs the IRS is best equipped to administer and which programs are better left to other agencies.<sup>26</sup> In the long run, we continue to believe that tax simplification is of overriding importance.

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**It is in the government's self-interest to facilitate voluntary compliance because voluntary compliance is far more cost effective than enforced compliance. For context, more than 98 percent of all tax revenue collected by the government is paid voluntarily and timely. Less than two percent is collected through enforcement action. If the IRS were to collect 10 percent less in enforcement revenue, tax revenue would decline by less than \$6 billion. If voluntary tax payments were to drop by 10 percent, tax revenue would decline by more than \$300 billion.**

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24 Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010).

25 See National Taxpayer Advocate 2012 Annual Report to Congress 3-23 (Most Serious Problem: *The Complexity of the Tax Code*); Testimony of Nina E. Olson, National Taxpayer Advocate, at *Hearing on Fundamental Tax Reform Before H. Comm. On Ways and Means*, 112th Cong. (2011), at <http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=219701>; National Taxpayer Advocate 2010 Annual Report to Congress 3-14 (Most Serious Problem: *The Time for Tax Reform Is Now*); National Taxpayer Advocate 2010 Annual Report to Congress 365-72 (Legislative Recommendation: *Enact Tax Reform Now*); National Taxpayer Advocate 2005 Annual Report to Congress 375-80 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*); Presentation of Nina E. Olson, National Taxpayer Advocate, at Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) at <http://www.taxreformpanel.gov/meetings/meeting-03032005.shtml>. Over the past decade, the National Taxpayer Advocate's annual reports have contained dozens of additional proposals to simplify particular sections or areas of the tax code.

26 In our 2010 Annual Report to Congress, we recommended adoption of a process to evaluate whether a tax expenditure presents an administrative challenge to the IRS or taxpayers and the extent to which it achieves its intended purpose. See National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-19 (*Evaluate the Administration of Tax Expenditures*). In our 2009 report, we proposed an analytic framework for evaluating whether specific social benefit programs—whether for individuals or for businesses—should be run through the tax system. See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-104 (*Running Social Programs Through the Tax System*). Among other factors, we suggested that Congress consider the IRS's existing relationship with and access to the targeted population as well as the additional burden imposed on that population, the IRS's ability to deliver the benefit in a timely manner and at the appropriate time, the IRS's access to the information required to make eligibility determinations, and the IRS's suitability to be the administrator of the provision in light of its enforcement culture.

In the short run, however, the IRS lacks sufficient resources to handle its growing workload. The National Taxpayer Advocate believes our government is not meeting the basic service needs of the taxpaying public, and if adequate funding is not provided, taxpayer service will continue to deteriorate.

### Why Taxpayer Service Matters

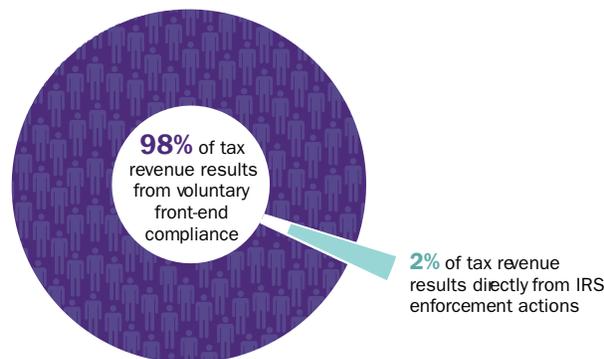
The proposition that the government should provide taxpayers with high quality service may seem obvious, but it is worth considering why taxpayer service is so important. In our view, there are two related but independent reasons.

First, it is, very simply, the right thing for the government to do for its taxpayers. The requirement to file a return and pay taxes is generally the most significant burden a government imposes on its citizens. The government therefore has a duty to make compliance as simple and painless as possible.

Second, it is in the government's self-interest to facilitate voluntary compliance because voluntary compliance is far more cost effective than enforced compliance. For context, more than 98 percent of all tax revenue collected by the government is paid voluntarily and timely. Less than two percent is collected through enforcement action.<sup>27</sup> If the IRS were to collect 10 percent less in enforcement revenue, tax revenue would decline by less than \$6 billion. If voluntary tax payments were to drop by 10 percent, tax revenue would decline by more than \$300 billion.

**FIGURE 1.1.2**

#### Tax revenue from voluntary compliance vs. enforcement actions



Some level of enforcement is necessary both to ensure that all taxpayers pay their fair share of taxes and to provide an incentive for all taxpayers to continue to comply. But we must not lose sight of the overriding importance of maintaining high levels of voluntary compliance, nor take it for granted. If the government treats its taxpayers poorly, voluntary compliance almost certainly will erode over time. Therefore, there is a strong business case for the government to provide sufficient funds for taxpayer service to ensure that taxpayer needs are adequately met.

<sup>27</sup> In FY 2014, the IRS collected total tax revenue of about \$3.1 trillion. Of that amount, it collected \$57.1 billion through enforcement actions. Government Accountability Office (GAO), GAO-15-173, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements* 29 (Nov. 2014), at <http://www.gao.gov/assets/670/666863.pdf>.

Yet as the discussion below shows, the workload of the IRS has been increasing over the past decade while the resources available to do its work have been shrinking, and the predictable result has been deteriorating levels of taxpayer service. We note that poor taxpayer service is not just limited to the IRS's pre-filing or filing activities. The quality of service the IRS provides to taxpayers in its enforcement functions has similarly eroded.<sup>28</sup>

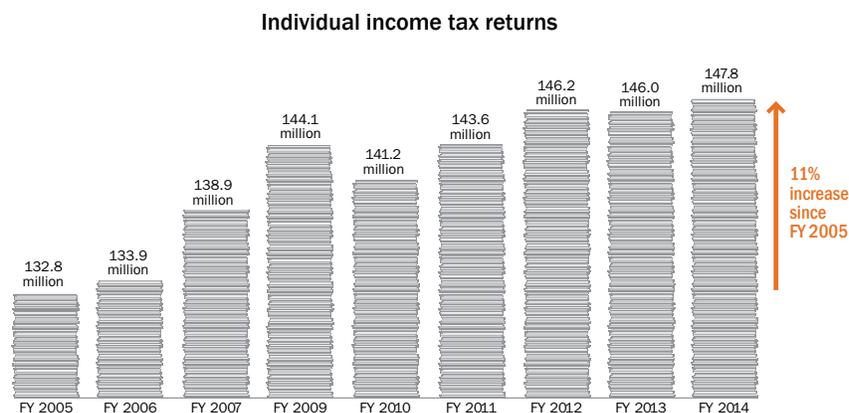
### The IRS's Workload Has Been Increasing

Because of the extensive nature of the IRS's responsibilities, no single metric provides an accurate reflection of changes in the agency's workload. However, two useful indicators are the number of tax returns processed and the number of telephone calls received.

Tax returns are a useful measure because the IRS's overall workload is largely derivative of the number of returns it receives. When that number increases, the IRS receives proportionately more telephone calls,<sup>29</sup> incurs proportionately greater costs to process the returns, performs proportionately more data matching, and would have to conduct proportionately more audits and take proportionately more collection actions to maintain consistent levels of enforcement.

From FY 2005 to FY 2014, the number of individual income tax returns rose from about 132.8 million to about 147.8 million, an increase of 11 percent. About 44 percent of that increase has occurred since FY 2010, when about 141.2 million returns were filed.<sup>30</sup>

**FIGURE 1.1.3**



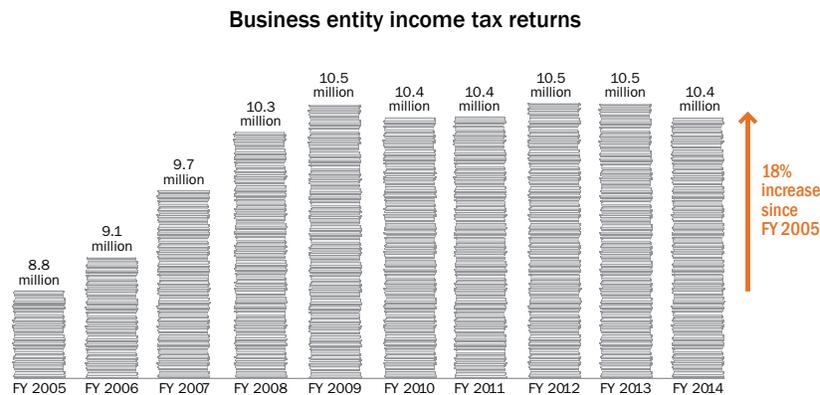
28 For a discussion of the relationship between IRS service functions, such as the IRS's toll-free telephone lines and its correspondence units, and IRS enforcement functions, see Preface, *supra*.

29 In FY 2014, the number of returns increased slightly while the number of telephone calls declined. The IRS's explanation for the reduction in calls in FY 2014 is discussed in the text below.

30 See IRS Data Books, Table 2 (showing return totals for FY 2005 through FY 2013). Data for FY 2014 are projections made by the IRS Office of Research, Analysis, and Statistics; see IRS Publication 6292, Fiscal Year Return Projections for the United States 2014-2021, at 4 (Fall 2014). In this and several other workload-trend charts in this section, we omit data for FY 2008 because the data for that year was extreme and aberrational. As discussed in more detail below, the Economic Stimulus Act of 2008 caused the number of telephone calls the IRS received on its Account Management phone lines to more than double from 67 million in FY 2007 to 151 million in FY 2008 and the number of individual income tax returns to increase from 139 million in FY 2007 to 154 million in FY 2008.

The percentage increase in returns was larger for business entities, which include C corporations, S corporations, and partnerships. From FY 2005 to FY 2014, the number of business entity returns rose from about 8.8 million to about 10.4 million, an increase of 18 percent.<sup>31</sup>

**FIGURE 1.1.4**



The number of telephone calls the IRS receives is also a useful measure of workload because answering phone calls is labor-intensive. As noted above, the IRS has received more than 100 million telephone calls in each year since 2008. Of those calls, the significant majority is directed to the “Accounts Management” phone lines, and the IRS focuses on this category of calls for purposes of measuring its “Level of Service” (discussed below).<sup>32</sup>

Since FY 2005, the IRS has seen a significant and continual increase in the number of calls it receives on its Accounts Management (AM) telephone lines, as shown in the graph below.<sup>33</sup> We note that two years on the graph are inconsistent with the general trend:

- In FY 2008, the IRS received an extraordinary one-time spike in telephone calls and returns due to enactment of the Economic Stimulus Act of 2008.<sup>34</sup> For that reason, we have omitted data from FY 2008 in several of the workload-trend charts included in this section.

31 See IRS Data Books, Table 2 (showing return totals for FY 2005 through FY 2013). Data for FY 2014 are projections made by the IRS Office of Research, Analysis, and Statistics; see IRS Publication 6292, *Fiscal Year Return Projections for the United States 2014-2021*, at 4 (Fall 2014).

32 The overall number of telephone calls the IRS receives is referred to as the “enterprise” total. The significant majority of those calls are directed to the AM telephone lines, which, among other things, provide answers to tax-law questions and account inquiries. A relatively small percentage of calls—typically about 16 million to 17 million calls—are directed to IRS compliance telephone lines and a few other less frequently used lines. Because of the purpose of the IRS’s “Level of Service” measure, those calls are excluded from the “Level of Service” computations.

33 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2005 through FY 2014).

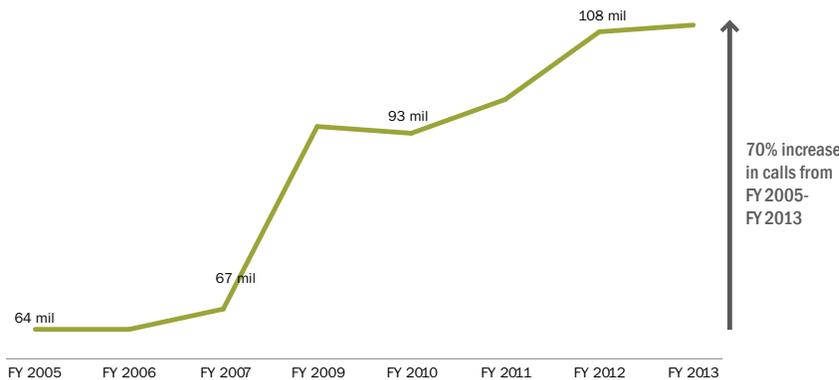
34 The Economic Stimulus Act of 2008, Pub. L. No. 110-185, 122 Stat. 613 (2008), required the IRS to make one-time payments to nearly 119 million taxpayers. See IRS News Release, IR-2009-10, *IRS Offers Tips to Avoid Recovery Rebate Credit Confusion* (Jan. 30, 2009), at <http://www.irs.gov/uac/IRS-Offers-Tips-to-Avoid-Recovery-Rebate-Credit-Confusion>. The procedures for claiming these “stimulus payments” required millions of individuals otherwise without a filing obligation to file a tax return. The stimulus payments were paid out over several months, and taxpayers who did not receive their payments early in the process inundated the IRS with telephone calls. As a result, many IRS measures reflect the effects of this one-time event. The number of calls the IRS received on its AM telephone lines more than doubled from FY 2007 to FY 2008 (increasing from 67 million to 151 million), and the number of individual income tax returns jumped from 139 million to 154 million – the highest annual totals in the past ten years and probably ever.

- In FY 2014, the IRS received significantly fewer telephone calls.<sup>35</sup> The IRS has attributed the reduction in calls to two factors. First, tax-law changes often generate taxpayer confusion, and Congress made changes to the Internal Revenue Code on only two occasions during 2013.<sup>36</sup> Second, the IRS significantly limited the scope of tax-law questions it answered.<sup>37</sup> To manage its workload, it adopted a policy of answering only “basic” tax-law questions until April 15 and then no tax-law questions after that date.<sup>38</sup> The virtual absence of tax legislation in 2013 was an aberration that is unlikely to recur; for context, Congress made nearly 4,200 changes to the Code over the preceding decade—an average of about 420 changes per year.<sup>39</sup> The restriction on tax-law-questions may continue, but we believe that taxpayer frustration will eventually lead the IRS, in collaboration with Members of Congress, to find ways to reinstate discontinued services. Therefore, we believe that any apparent “improvements” in FY 2014 are illusory.

Omitting FY 2008 and FY 2014, the number of calls the IRS received on its AM lines over the past decade soared from about 64 million in FY 2005 to about 109 million in FY 2013, or about 70 percent. That is a substantial increase that requires significantly more resources to handle.<sup>40</sup>

**FIGURE 1.1.5**

**Taxpayer calls to IRS Accounts Management telephone lines**



35 In FY 2014, the IRS received 86 million calls on its Accounts Management telephone lines. IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (Sept. 30, 2014).

36 According to a GAO report, the IRS attributes the decline in taxpayer telephone calls in FY 2014 partly to “smooth tax return and refund processing” and partly to its “efforts to limit or eliminate assistor-based services and direct taxpayers to self-service options.” GAO, GAO-15-163, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks* 11 (Dec. 2014). The report says the IRS attributed its smooth return processing, in turn, to “fewer tax-law changes that resulted in fewer system and form updates compared to previous years.” *Id.* at 9.

37 *Id.*

38 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

39 Unpublished data provided to TAS by Wolters Kluwer, CCH (Dec. 12, 2012, supplemented on Sept. 29, 2014).

40 The majority of the additional calls was handled by automation. The increase in calls seeking to speak with a customer service representative was 23 percent. See IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of fiscal years 2005 and 2013) (indicating that the number of calls seeking to reach a representative on the Account Management telephone lines increased from about 40.4 million to about 49.8 million). The percentage increase in calls seeking to reach an assistor likely would have been considerably higher absent IRS policies designed to drive more taxpayers to use automated processes.

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While the National Taxpayer Advocate believes the IRS can operate more effectively and efficiently in certain areas, the only way the IRS can assist the tens of millions of taxpayers seeking to speak with an IRS employee is to have enough employees to answer their calls. The only way the IRS can timely process millions of letters from taxpayers is to have enough employees to read their letters and act on them. And the only way the IRS can meet the needs of the millions of taxpayers who visit its walk-in sites is to have enough employees to staff them.

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There are several other obvious sources of workload increase. First, the IRS has had to address a huge spike in tax-related identity theft and refund fraud. In FY 2014, the IRS assigned more than 3,000 employees to work on identity theft cases, which reduced the number of employees available to handle the IRS's traditional workload.<sup>41</sup> Second, and as mentioned above, Congress has continued to make significant changes to the tax code over the past decade—an average of about 420 changes per year from 2003 to 2012, according to one count.<sup>42</sup> Tax-law changes add to the IRS's workload, variously requiring the agency to reprogram its return processing systems, issue interpretative regulations or other guidance, and train its telephone assistants and auditors. Third, the Patient Protection and Affordable Care Act has been a heavy lift for the agency and will become even heavier in 2015—the Act's first year of substantial implementation.<sup>43</sup> Finally, the implementation of the Foreign Account Tax Compliance Act is also requiring changes to IRS technology and the commitment of personnel.

The combination of more tax returns, substantially more telephone calls, substantially more cases of tax-related refund fraud, and continual tax law changes, including implementation of the ACA and FATCA, have sharply increased the IRS's workload.

### The IRS's Resources Have Been Declining Overall

At the same time that the IRS's workload has been increasing, the resources available to handle that workload have been declining, particularly in inflation-adjusted dollars.

In FY 2005, the IRS operated on an appropriated budget of \$10.24 billion.<sup>44</sup> From FY 2005 to FY 2015 (projected), the non-defense sector of the U.S. economy has experienced price inflation of about 21.8 percent.<sup>45</sup> If the IRS's FY 2005 budget had kept pace with inflation, its budget in FY 2015 would be \$12.47 billion. In fact, the IRS's funding level for FY 2015 has been set at \$10.95 billion.<sup>46</sup> Thus, the IRS's budget has been reduced by approximately 12.2 percent since FY 2005 in inflation-adjusted terms.<sup>47</sup>

41 IRS Wage & Investment Division, Business Performance Review 25 (3rd Quarter – FY 2014, Nov. 6, 2014).

42 Unpublished data provided to TAS by Wolters Kluwer, CCH (Dec. 12, 2012, supplemented on Sept. 29, 2014). Congress made very few changes to the tax code in 2013. The number rose considerably in 2014, but a final count was not available as of our publication deadline.

43 See Most Serious Problem: *HEALTH CARE IMPLEMENTATION: Implementation of the Affordable Care Act May Unnecessarily Burden Taxpayers*, *infra*.

44 See Internal Revenue Service FY 2007 Budget-in-Brief, at <http://www.irs.gov/pub/irs-news/fy07budgetinbrief.pdf> (showing enacted FY 2005 IRS appropriation of \$10,236,087,000).

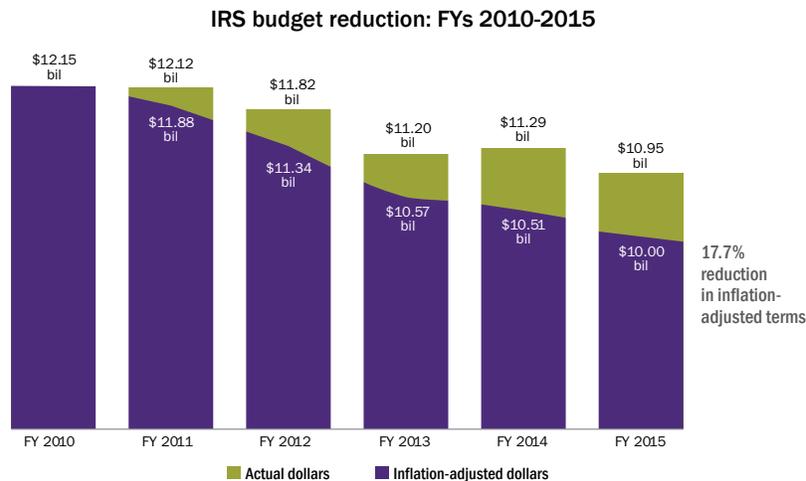
45 See Office of Management and Budget, *Fiscal Year 2015 Budget of the U.S. Government, Historical Tables*, Table 10.1, at 217-218, at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/hist.pdf> (showing Gross Domestic Product and year-to-year increases in the GDP). For budgeting purposes, our understanding is that federal agencies use the Gross Domestic Product deflator, as reflected in the OMB charts.

46 Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, Title I, 128 Stat. 2130, 2332 (2014). The total IRS appropriated budget represents the sum of the Taxpayer Services, Enforcement, Operations Support, and Business Systems Modernization accounts.

47 Budget numbers have been rounded, but percentage changes were computed using exact values.

From FY 2005 through FY 2010, the IRS's budget increased, but it has been cut sharply since.<sup>48</sup> In FY 2010, the agency's appropriated budget stood at \$12.1 billion. In FY 2015, its budget was set at \$10.9 billion, a reduction of about 9.9 percent. Inflation over the same period is estimated at about 9.4 percent.<sup>49</sup> In combination, the budget reduction and the effects of inflation suggest an effective reduction of nearly 18 percent.

**FIGURE 1.1.6**



Because of the three-year federal pay freeze, we believe the impact of inflation may be slightly less than broad economic measures would suggest. Taking the effects of the pay freeze into account, we estimate the effective reduction in the IRS budget since FY 2010 has been about 17 percent.<sup>50</sup>

48 See Department of the Treasury, Budget-in-Brief, at <http://www.treasury.gov/about/budget-performance/budget-in-brief/pages/default.aspx> (available for each fiscal year).

49 See Office of Management and Budget, *Fiscal Year 2015 Budget of the U.S. Government, Historical Tables*, Table 10.1, at 217-218 (showing Gross Domestic Product (GDP) and year-to-year increases in the GDP) at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/hist.pdf>.

50 To determine whether IRS costs rose roughly in proportion to the Gross Domestic Product measure of inflation, we estimated the reduction in the IRS's resources using a different methodology and compared the results. Because the majority of the IRS budget is spent on employee salaries, we used the size of the IRS workforce as a proxy for the inflation-adjusted impact of budget changes over time. From FY 2010 to FY 2014, the number of full-time-equivalent employees (including seasonal employees) fell from 94,618 to 82,982, a drop of 12.3 percent. While the number of employees in FY 2015 has not yet been determined, the agency's budget has been reduced by 3.1 percent overall, and the IRS Commissioner has said the IRS faces cost increases of \$250 million, or 2.2 percent compared with FY 2014 funding levels. Email from Commissioner Koskinen to all employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014) (i.e., a \$250 million increase in costs from the FY 2014 appropriated budget of \$11,290,612,000 translates to a 2.2 percent increase). Viewing in combination the FY 2010 to FY 2014 reduction in staffing of 12.3 percent, the FY 2014 to FY 2015 reduction in the IRS appropriated budget of 3.1 percent, and the Commissioner's statement that the IRS's costs will rise by 2.2 percent in FY 2015, this methodology suggests the inflation-adjusted reduction in the IRS budget from FY 2010 to FY 2015 was approximately 17.6 percent. That result is almost identical to the result produced using the GDP measure of inflation. For purposes of this report, we estimate the inflation-adjusted reduction in the IRS budget from FY 2010 to FY 2015 at about 17 percent (about 10 percent due to the dollar-denominated reduction and about 7 percent due to cost increases).

### The IRS's Resources for Taxpayer Services Have Declined Along with Its Overall Budget

Because the IRS budget consists of several accounts, of which Taxpayer Services is just one, we have also analyzed the trends in funding for taxpayer services. Under the current budget structure, the IRS receives funding through four accounts:

- Taxpayer Services;
- Enforcement;
- Operations Support; and
- Business Systems Modernization.

Over the ten-year period from FY 2006–FY 2015, the Taxpayer Services account received a significantly smaller pre-inflation funding increase than the overall IRS budget.<sup>51</sup> The overall IRS budget rose by 3.5 percent, while Taxpayer Services funding increased by only 0.7 percent. However, the changes did not occur evenly over the decade. From FY 2006–FY 2010, the Taxpayer Services account received considerably smaller increases than the overall IRS budget. From FY 2010–FY 2015, Taxpayer Services fared relatively better because it sustained smaller cuts, with the overall IRS budget reduced by 9.9 percent and the Taxpayer Services budget reduced by 5.4 percent.

In enacting the IRS's budget for FY 2015, Congress cut all accounts except Taxpayer Services, for which it provided the same funding as in FY 2014.<sup>52</sup> While that is comparatively welcome news, the resources available for the IRS to provide taxpayer services will still be lower in FY 2015 for two reasons. First, the Office of the IRS Chief Financial Officer has advised us that approximately 40 percent of the dollars in the Operations Support account, or \$1.5 billion, are apportioned to support Taxpayer Services operations, and the Operations Support account has been reduced by 4.2 percent.<sup>53</sup> A cut of 4.2 percent to \$1.5 billion translates to a reduction of about \$64 million for taxpayer service support.

Second, the Administration's budget proposal provided an estimate of additional funding that would be required in FY 2015 to maintain the same services provided in FY 2014 (known as "Maintaining Current Levels" or "MCLs").<sup>54</sup> The combined MCLs for the Taxpayer Services account and 40 percent of the Operations Support account are about \$138 million. Thus, the effective reduction in funds available to support taxpayer services will be about 3.8 percent.

51 In discussing 10-year trends in other portions of this discussion, we focus on the FY 2005–FY 2014 period. In discussing the Taxpayer Services account, however, relevant data for FY 2005 is not available. Congress realigned the IRS account structure beginning in FY 2007. The IRS Budget-in-Brief for FY 2008 showed how funding for years going back to FY 2006 would have been allocated under the new structure, but no such information was made available for earlier years. See Internal Revenue Service, FY 2008 Budget-in-Brief, at <http://www.irs.gov/pub/newsroom/budget-in-brief-2008.pdf>.

52 Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235, Division E, Title I, 128 Stat. 2130, 2332 (2014). The total for FY 2014 includes base funding of \$2,122,554,000 and a \$34 million supplement reflecting the portion of a \$92 million non-recurring additional appropriation allocated to the Taxpayer Services account.

53 Funding for the Operations Support account was reduced from about \$3.8 billion in FY 2014 to about \$3.6 billion in FY 2015 (the reduction comes to 4.2 percent when exact numbers are used). The Operations Support account covers, among other things, infrastructure, including rent for IRS office space; shared services and support, including agency management functions, procurement, human resources, and certain employee benefits programs; and information services, including return processing and other tax administration technology systems, and employee technology.

54 See Internal Revenue Service, FY 2015 Budget-in-Brief 5, at <http://www.irs.gov/PUP/newsroom/IRS%20FY%202015%20Budget%20in%20Brief.pdf>

**FIGURE 1.1.7, Reduction in funding for taxpayer service activities from FY 2014–FY 2015**

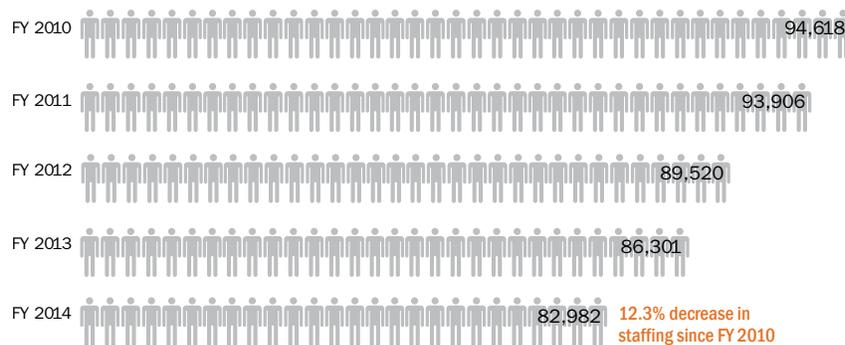
	FY 2014	FY 2015	Maintain current levels	FY 2015 Adjusted
Taxpayer services	\$2,156,554,000	\$2,156,554,000	\$(46,483,000)	\$2,110,071,000
Operations support dollars allocated to taxpayer services	\$1,519,577,000	\$1,455,378,000	\$(27,753,000)	\$1,427,625,000
<b>Total</b>	<b>\$3,676,131,000</b>	<b>\$3,611,932,000</b>	<b>\$(74,236,000)</b>	<b>\$3,537,696,000</b>
<b>Percent change</b>		<b>-1.7%</b>		<b>-3.8%</b>

**Declining Resources Have Led to a Reduced Workforce and Insufficient Employee Training**

In light of the significant cuts to its budget, the IRS has substantially reduced the number of employees since FY 2010. The following chart shows that the number of full-time-equivalent employees has fallen by 12.3 percent from FY 2010 to FY 2014.<sup>55</sup>

**FIGURE 1.1.8**

**Full-time equivalent IRS employees including seasonals**



In light of the inflation-adjusted reduction to the IRS budget in FY 2015, the Commissioner has stated that the IRS workforce will shrink by several thousand additional employees.<sup>56</sup>

There is a close and obvious connection between the number of IRS employees and the IRS’s ability to meet taxpayer needs. While the National Taxpayer Advocate believes the IRS can operate more effectively and efficiently in certain areas, the only way the IRS can assist the tens of millions of taxpayers seeking to speak with an IRS employee is to have enough employees to answer their calls. The only way the IRS can timely process millions of letters from taxpayers is to have enough employees to read their letters and act on them. And the only way the IRS can meet the needs of the millions of taxpayers who visit its walk-in sites is to have enough employees to staff them.

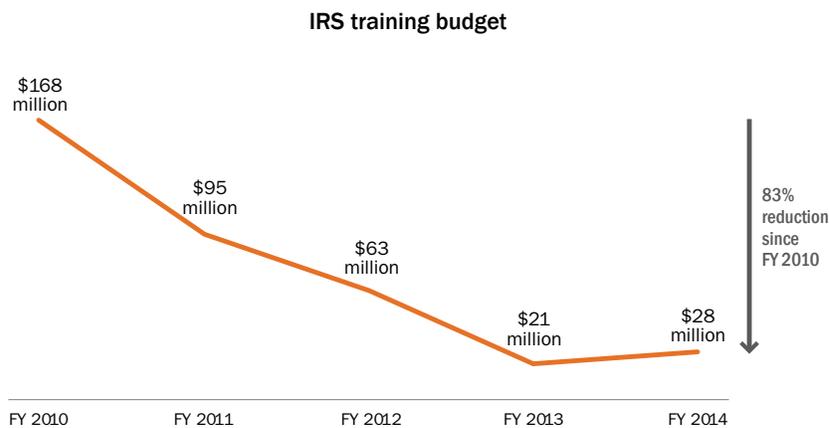
55 IRS Chief Financial Officer, Corporate Budget. These figures represent actual full-time equivalent employees realized through appropriated dollars.

56 Email from Commissioner Koskinen to all employees, *Fiscal Year 2015 Funding* (Dec. 17, 2014).

A closely related issue is employee training. In light of the complexity of the tax code and the wide range of issues that arise in tax administration, employees who interact with taxpayers require extensive training. It is of little value—and it is frustrating to taxpayers—if employees on the front lines cannot provide proper assistance.

The following charts show that the IRS’s training budget, while up slightly in FY 2014 as compared with FY 2013, is still 83 percent below its FY 2010 level and that dollars spent on training per full-time-equivalent employee have declined substantially.<sup>57</sup>

**FIGURE 1.1.9**



**FIGURE 1.1.10, Training dollars per full-time equivalent (FTE) employee**

Fiscal year	Number of FTEs	Training dollars per FTE
2010	94,618	\$1,774
2011	93,906	\$1,014
2012	89,520	\$705
2013	86,301	\$240
2014	82,982	\$339

As discussed in more detail below, the combination of fewer employees and less training has impaired the IRS’s ability to meet taxpayers’ service needs.

**The Gap Between an Increasing Workload and Declining Resources Has Left the IRS Unable to Meet Taxpayer Needs, and Due to Concerns the Gap Will Widen, the IRS is Considering Long-Term Strategies That Will Cause Significant Harm to Groups of Taxpayers**

Many taxpayers use the Internet as their initial method of obtaining forms or other information from the IRS. For well over a decade, the IRS has devoted considerable resources to building and improving its website, and it is continuing to improve the availability of its resources online. Yet despite the IRS’s efforts to transition taxpayers to its website, demand for personal contact has increased.

57 IRS Chief Financial Officer, Corporate Budget.

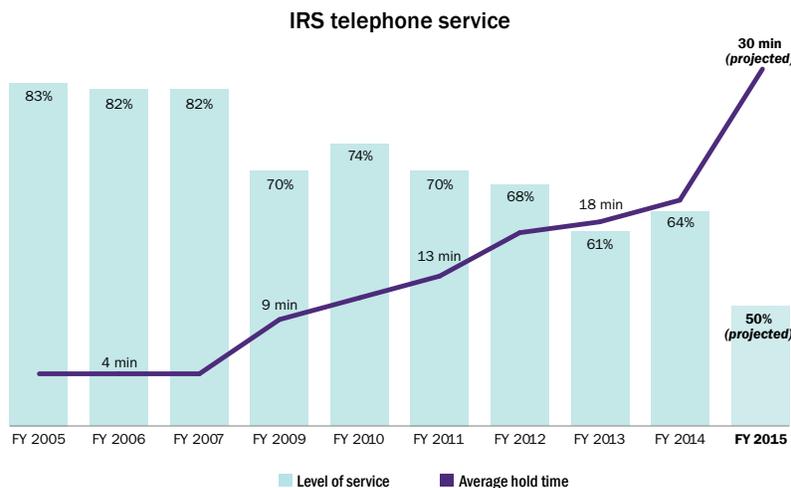
**a. Taxpayer Telephone Calls**

During the past decade, the IRS’s ability to answer taxpayer telephone calls—and do so promptly—has been declining. Among callers trying to reach a customer service representative on the IRS’s Accounts Management telephone lines, the “Level of Service” (*i.e.*, the percentage of calls the IRS is able to answer among all callers seeking to reach a representative) decreased from 83 percent in FY 2005 to 64 percent in FY 2014.<sup>58</sup>

As noted above, FY 2014 was anomalous because the IRS overall received about 24 million fewer calls than the year before, including about 14 million fewer calls seeking to speak with a customer service representative. As a result, the IRS was able to answer about seven million fewer telephone calls than in FY 2013 and still raise its Level of Service from 61 percent to 64 percent.<sup>59</sup> Had the IRS received the same number of calls seeking to reach a representative in FY 2014 as it had received the previous year without additional staffing, the number of calls it answered would have produced a Level of Service below 50 percent.<sup>60</sup>

Moreover, even with the reduction in calls, the hold time for taxpayers who got through to an assistor reached nearly 20 minutes—the continuation of a worsening trend and far longer than the four-minute hold time at the beginning of the 10-year period.<sup>61</sup>

**FIGURE 1.1.11**



In FY 2014, the IRS reduced taxpayer services in several areas to conserve resources. One of the most significant and concerning reductions was to the scope of tax-law questions it answered. During the filing season (January through April), it announced it would answer only “basic” tax-law questions. It declined to answer “more complex” questions. It announced that after the April 15 filing deadline, it would not answer *any* tax-law questions (even basic ones), including tax-law questions from about 15 million

58 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2005 through FY 2014).

59 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of fiscal years 2013 and 2014).

60 *Id.*

61 IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for FY 2005 through FY 2014).

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**We are deeply concerned that the government is largely turning its back on the significant number of taxpayers who require face-to-face assistance to comply with their tax obligations.**

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taxpayers who obtained filing extensions or otherwise filed their returns later in the year.<sup>62</sup> We think it is a sad state of affairs when the government writes tax laws as complex as ours—and then is unable to answer any questions beyond “basic” ones from baffled citizens who are doing their best to comply.<sup>63</sup>

As we discussed earlier, the IRS believes its decision to answer only “basic” tax-law questions, combined with fewer-than-usual tax-law changes, was responsible for at least a portion of the decline in telephone calls last year. What this makes clear is that the increase in the Level of Service on the toll-free telephone lines last year was not due to improved taxpayer service. Rather, it came about partly because Congress happened to make virtually no changes to the tax code and partly because the IRS simply shrank the categories of services it provides. Thus, the small “improvement” in the percentage of calls getting through to the IRS occurred, at least in part, because the IRS made a conscious decision to diminish the services it provides to taxpayers.

#### **b. Taxpayer Correspondence**

Just as the IRS’s ability to handle its telephone call volumes has declined over the past decade, its ability to timely process taxpayer correspondence has also fallen off. When the IRS sends a taxpayer a notice proposing to increase his or her tax liability based on math error authority<sup>64</sup> or asserts a penalty against a taxpayer during processing, it typically gives the taxpayer an opportunity to present an explanation or documentation supporting the position taken on the return. Also, before the IRS sends the account of a delinquent taxpayer to its Collection function, the IRS sends the taxpayer a series of notices explaining the balance due and giving the taxpayer the opportunity to pay the debt. Each year, the IRS typically receives around ten million taxpayer responses to these notices, which are known collectively as the “adjustments inventory.”<sup>65</sup>

The IRS has established timeframes for processing taxpayer correspondence, generally 45 days. During the final week of FY 2005, the IRS failed to process two percent of its adjustments correspondence within its timeframes. During the final week of FY 2014, the IRS was unable to process 51 percent of

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62 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>. In both 2013 and 2014, the number of tax returns received after the filing season was about 15 million. See IRS 2014 Filing Season Statistics, at <http://www.irs.gov/uac/2014-and-Prior-Year-Filing-Season-Statistics> (showing 134.3 million returns received by April 25, 2014 and 149.2 million returns received by Nov. 21, 2014, an increase of 14.9 million; the increase over the same time period in FY 2013 was virtually identical.).

63 In fact, one could argue that the IRS should focus primarily on answering complex questions and direct taxpayers seeking answers to simple questions to IRS.gov or IRS publications. However, a question that seems simple to one taxpayer may appear complex to another. For this reason, we believe “*The Right to Quality Service*” means the IRS should answer both simple and complex questions.

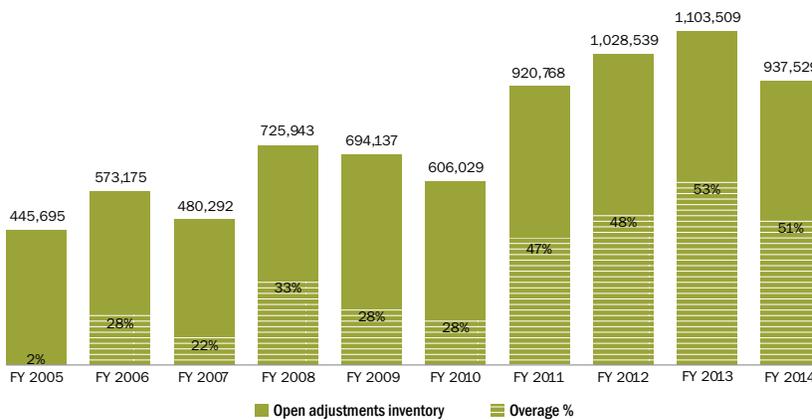
64 See IRC § 6213(b)(1), (g).

65 IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2005 through FY 2014)*.

its adjustments correspondence within the timeframes. That represents a 2,450 percent increase in the percentage of taxpayer correspondence that the IRS could not answer within its established timeframes.<sup>66</sup>

**FIGURE 1.1.12**

**Open adjustments inventory at fiscal year end**



When the IRS becomes backlogged in processing correspondence, it often leads to adverse taxpayer impact. For a taxpayer who owes additional tax, interest charges and penalties generally will continue to accrue. For a taxpayer who has overpaid, a delay in processing correspondence may translate into a delay in receiving a refund.

As with telephone performance, correspondence performance has dropped off since FY 2010. Comparing the final week of FY 2010 with the final week of FY 2014, the percentage of overage correspondence rose from 28 percent to 51 percent, and open inventory grew from about 606,000 to about 938,000—both significant increases.<sup>67</sup>

**c. Taxpayer Walk-in Assistance**

Many taxpayers prefer to communicate with the IRS in person. As an alternative to telephone or correspondence interaction, the IRS maintains walk-in sites known as Taxpayer Assistance Centers, or “TACs.” These sites are particularly important for taxpayers who do not have Internet access and for the low income, elderly, disabled, and Limited English Proficiency (LEP) populations. Over the past decade, the

66 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Sept. 27, 2014). In auditing IRS correspondence operations, the GAO uses a broader definition of “taxpayer correspondence” than ours. According to the GAO: “We define taxpayer correspondence as written communication from taxpayers as well as work internally generated by IRS employees. This includes amended returns, carry back claims, employer identification numbers, identity theft, and refund check problems.” The GAO “[does] not include correspondence between taxpayers and IRS’s compliance and Automated Underreporter offices as this relates to ongoing work.” GAO, GAO-11-111, *2010 Tax Filing Season: IRS’s Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 15 n.29 (Dec. 2010). Under the GAO’s broader definition of “taxpayer correspondence,” the IRS received about 20 million pieces of mail overall in FY 2014, and about 50 percent of the inventory was not handled within established timeframes (e.g., it was “overage”). See GAO, GAO-15-163, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks* 18 (Dec. 2014).

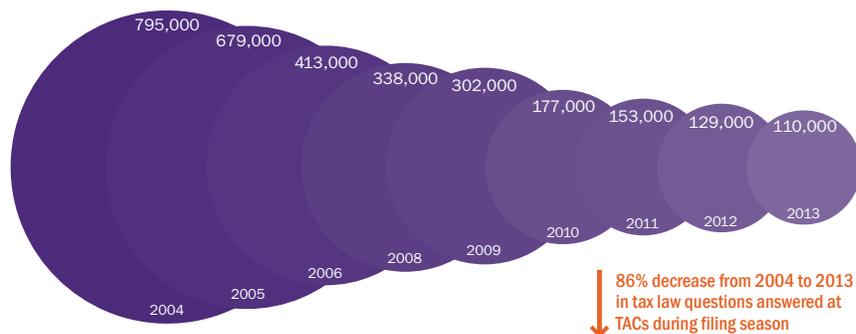
67 IRS, Joint Operations Center, *Weekly Enterprise Adjustments Inventory Report* (week ending Oct. 2, 2010 and Sept. 27, 2014).

services the IRS provides at the TACs have also been limited in several ways. First, the IRS has reduced the number of operational TACs.<sup>68</sup>

Second, we described above that the IRS implemented a new policy last year of declining to answer many tax-law questions—notably, those considered beyond “basic” questions—on its toll-free telephone lines during the filing season and declining to answer *any* tax-law questions after the filing season. The same policy applies at the TACs.<sup>69</sup> According to data compiled by the GAO, the number of tax-law questions answered in the TACs between 2004 and 2013 during the filing season declined by 86 percent—from about 795,000 questions to 110,000.<sup>70</sup>

**FIGURE 1.1.13**

**Tax law questions answered at  
Taxpayer Assistance Centers (TACs) during filing season**



In the past, the annual GAO filing season reports generally did not list the number of tax-law questions outside the filing season, but the numbers are significant. In FY 2004, for example, IRS data indicate that in addition to handling some 795,000 tax-law questions during the filing season, the IRS handled about 638,000 tax-law questions after the filing season. Thus, 45 percent of the 1.433 million questions

68 Between 2011 and 2014, the number of TACs declined from 401 to 382, and the number of TACs with zero or one full-time employee increased from 37 to 80. IRS Wage & Investment Division Response to TAS Information Request (Dec. 23, 2014). TACs with fewer than two employees are subject to unexpected closure due to employee absence and subject to extended wait times when there are more-than-projected taxpayer visits. For more detail, see National Taxpayer Advocate FY 2014 Objectives Report to Congress at 59.

69 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

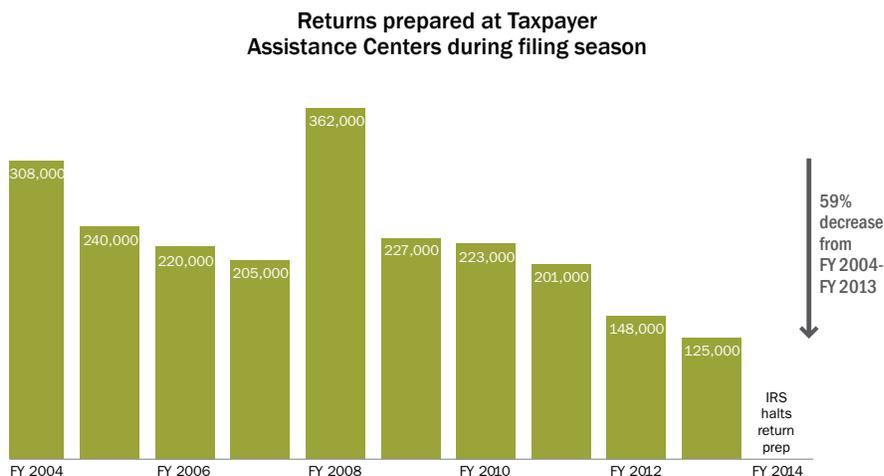
70 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO-11-111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO-08-38, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated* 27-28 (Nov. 2007); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006). To our knowledge, the GAO did not publish comparable data for 2007 or 2014. In a December 2014 report, the GAO published data for FY 2009–FY 2014 that shows a decline of 42 percent in tax-law questions from FY 2013 to FY 2014. However, the data in the report appears to cover more than just the filing season and therefore is not directly comparable to the data for earlier years. See GAO, GAO-15-163, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks* 40 (Dec. 2014).

received came outside the filing season.<sup>71</sup> None of those 638,000 questions would be answered under the IRS’s new policy.

It should be emphasized that the reduction in tax-law questions is not necessarily a function of reduced demand. Rather, the IRS has reduced TAC staffing and reduced the scope of the questions it is willing to answer, and wait times have often been unreasonably long. As a consequence, many taxpayers have simply given up.

Third, the TACs historically prepared tax returns for taxpayers seeking assistance, particularly low income, elderly, and disabled taxpayers. Over the past decade, the IRS has taken steps to reduce return preparation assistance in order to conserve resources. According to the GAO filing season reports, the number of returns prepared during the filing season from 2004 to 2013 declined by 59 percent.<sup>72</sup>

**FIGURE 1.1.14**



As with tax-law questions, data covering solely the filing season understates the assistance the IRS has provided to taxpayers. In FY 2004, IRS data indicates that in addition to preparing some 308,000 returns during the filing season, the IRS prepared an additional 168,000 returns after the filing season. Thus, roughly 35 percent of the returns prepared by the TACs were prepared after April 15.<sup>73</sup> But with

71 This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*). TAS does not have data on tax-law questions asked outside the filing season for more recent years.

72 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO-11-111, *2010 Tax Filing Season: IRS’s Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO-08-38, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated* 27-28 (Nov. 2007); GAO, GAO-07-27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with more precise IRS data provided to TAS by the IRS Wage & Investment Division for 2004 through 2006); GAO, GAO-05-67, *Tax Administration: IRS Improved Performance in the 2004 Filing Season, But Better Data on the Quality of Some Services Are Needed* 18 (Nov. 2004). The GAO filing season reports do not provide a total for 2007. However, the report on the 2007 filing season said the number of TAC-prepared returns was almost 74 percent less than the number of TAC-prepared returns in 2001, and the report on the 2004 filing season said the number of TAC-prepared returns in 2001 was about 790,000. We therefore have provided an approximate total for 2007 in the chart above.

73 This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate 2007 Annual Report to Congress 162-182 (Most Serious Problem: *Service at Taxpayer Assistance Centers*).

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It is unacceptable that the IRS may only be able to answer about half the calls it receives, that it will not be able to answer any tax-law questions beyond “basic” ones (and none at all beyond April), and that wait times to speak with customer service representatives will average about a half hour. All too often, the message the government is sending to U.S. taxpayers doing their best to comply with the law is, “We’re sorry. You’re on your own.” U.S. taxpayers deserve better.

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dwindling resources, the IRS had been placing increasing limits on return preparation assistance, and last year it made the decision to discontinue *all* return preparation assistance at the TACs.<sup>74</sup>

These service cutbacks represent a withdrawal from the IRS’s longstanding commitment to provide face-to-face assistance to taxpayers, particularly those who do not have Internet access or who encounter special challenges communicating with the IRS by mail or by phone, often because of language barriers. There is no doubt that organizations can achieve efficiencies by centralizing and automating operations, and centralized service delivery may be adequate for the majority of taxpayers. However, automated services do not meet the needs of many taxpayers. We are deeply concerned that the government is largely turning its back on the significant number of taxpayers who require face-to-face assistance to comply with their tax obligations. The net effect of withdrawing this assistance is that many taxpayers will not receive the help they need and many others will have to pay for a previously free service, often consulting “tax preparers” who generally are unregulated and do not have to meet even minimum competency requirements.<sup>75</sup>

### IRS Oversight Bodies Have Begun to Take Note of the Significance of Service Reductions

The significant IRS budget reductions that have taken place since FY 2010 result from two factors. First, Congress has reduced domestic discretionary spending, including IRS appropriations, as part of an agreement to reduce the federal budget deficit.<sup>76</sup> Second, reports by the Treasury Inspector General for Tax Administration (TIGTA) that the IRS used inappropriate criteria to screen certain applicants for tax-exempt status<sup>77</sup> and that an IRS business unit had

74 IRS, e-News for Tax Professionals – Issue Number 2013-49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources>.

75 Since 2002, the National Taxpayer Advocate has been recommending that Congress establish minimum standards for return preparers. On two occasions, the Senate Finance Committee on a bipartisan basis approved legislation to implement our recommendation. H.R. 1528 (incorporating S. 882) (108th Cong.); S. 1321 (incorporating S. 832) (109th Cong.). On one occasion, the full Senate approved the legislation as well. H.R. 1528 (incorporating S. 882) (108th Cong.). The House has not taken up companion legislation, but the Ways and Means Oversight Subcommittee held a hearing in 2005 at which five leading tax practitioner and preparer organizations testified in support of minimum preparer standards. See *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 109th Cong. (2005). Beginning in 2011, the IRS attempted to implement minimum preparer standards administratively, but the U.S. Court of Appeals for the District of Columbia upheld a district court decision invalidating the regulations, concluding that the IRS lacked the authority to regulate return preparers. *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014), *aff’g* 917 F.Supp.2d 67 (D.D.C. 2013). The National Taxpayer Advocate continues to recommend that Congress pass legislation to establish minimum preparer standards or authorize the IRS to do so. For a detailed discussion of this issue, see National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined from Continuing its Efforts to Effectively Regulate Return Preparers*).

76 The most significant budget reduction was imposed in FY 2013 as a result of sequestration. See Pub. L. No. 112-25, 125 Stat. 240 (2011).

77 TIGTA, Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 2013).

misspent appropriated funds have raised concerns about the management of the agency.<sup>78</sup> The IRS has undergone leadership changes since that time, but concerns persist.

As discussed above, the agency's budget has been reduced by about 10 percent before taking account of inflation and by about 17 percent when cost increases are considered. Those reductions have had a significant impact on all IRS operations.

From a taxpayer advocacy perspective, we are pleased that that IRS oversight bodies are beginning to recognize the impact these reductions are having on taxpayer service.

### a. Congress

The most important IRS overseer is, of course, Congress. Several Members of Congress have made clear publicly and privately that, despite concerns about the IRS overall, they consider it important that the service needs of their constituents be met.

In enacting the IRS's budget for FY 2015, Congress spared the Taxpayer Services account from the reductions it made to other IRS accounts. In addition, the Appropriations Committees' Explanatory Statement accompanying the final bill directed the IRS to "alleviate difficulties faced by rural taxpayers seeking guidance and assistance to properly file their returns" and, more broadly, to examine "the impacts on minority, rural, elderly, disabled, and low-income populations" of certain service reductions the IRS has implemented.<sup>79</sup>

The National Taxpayer Advocate appreciates the Appropriations Committees' attention to the IRS's declining service capabilities and their awareness of the impact declining services are having on taxpayers, particularly rural taxpayers and other taxpayers who face particular challenges navigating the tax system. She will continue to monitor the IRS's performance in meeting taxpayer needs and will keep the committees up to date regarding her findings and concerns.

### b. The Government Accountability Office

The GAO maintains extensive audit coverage over IRS operations, and in particular, issues an annual review of the filing season. By 2012, the GAO was seeing a significant impact to taxpayers. In 2013, it titled its filing season report, "IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources."<sup>80</sup> Among other things, it noted that "[d]espite efficiency gains . . . , the [IRS] was unable to keep up with the demand for telephone and correspondence services."<sup>81</sup> It reiterated its prior-year recommendation that the IRS undertake a "dramatic revision in [its] taxpayer service strategy . . . to better balance demand for services with available resources."<sup>82</sup>

The "dramatic revision" is needed because the GAO recognized that the imbalance between funding and taxpayer demand for services has reached a point where taxpayer needs are not being adequately met. The

78 See, e.g., TIGTA, Ref. No. 2013-10-037, *Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California* (May 2013).

79 Explanatory Statement accompanying H.R. 83, Consolidated and Further Continuing Appropriations Act, 2015 – Division E, at 10, at <http://rules.house.gov/sites/republicans.rules.house.gov/files/113-1/PDF/113-HR83sa-ES-E.pdf> (became Pub. L. No. 113-235).

80 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources*, "Highlights" page (Dec. 2013).

81 *Id.*

82 *Id.*

GAO recommended that the IRS strategy could be used “to facilitate a discussion with Congress and other stakeholders about the appropriate mix of service, level of performance, and resources.”<sup>83</sup>

In its report on the 2014 filing season, the GAO again noted its concern about service levels:

Since fiscal year 2010, IRS has absorbed approximately \$900 million in budget cuts, resulting in significant staffing declines. Performance has declined in both enforcement and taxpayer services including telephone and correspondence services.<sup>84</sup>

### c. Treasury Inspector General for Tax Administration

TIGTA has also called attention to the IRS’s funding challenges in its audit reports and congressional testimony. For example, in testimony before the Senate Appropriations Subcommittee on Financial Services and General Government in April 2014, the Inspector General stated:

These budget constraints continue to result in the IRS cutting service to taxpayers which make it difficult for the IRS to effectively assist taxpayers. As demand for taxpayer services continues to increase, resources devoted to customer service have decreased, thereby affecting the quality of customer service that the IRS is able to provide.<sup>85</sup>

### d. IRS Oversight Board

The IRS Oversight Board consistently has been recommending that the IRS budget be increased and has been expressing concern about the impact of budget cuts on taxpayer service.<sup>86</sup> In addition, the Oversight Board has conducted a Taxpayer Attitude Survey in each year since 2004. In the 2014 survey, 74 percent of taxpayers reported they were satisfied with their personal interaction with the IRS. While that is a respectable number, the Board indicated it was a notable decline from prior years. In releasing the survey, IRS Oversight Board Chairman Paul Cherecwich, Jr., stated:

Taxpayer satisfaction with IRS customer service has fallen to its lowest level in more than a decade. The Board believes this can be directly tied to deep cuts in IRS funding which have served only to punish honest America’s taxpayers who must endure long wait times over the IRS toll-free telephone lines and at walk-in centers. Taxpayers understand what’s going on—a solid majority [61 percent] supports extra funding for IRS customer service .... It is time to reinvest in the IRS to help honest taxpayers comply with a complex tax code and to protect the integrity of our tax system.<sup>87</sup>

83 GAO, GAO-14-133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources*, “Highlights” page (Dec. 2013).

84 See GAO, GAO-15-163, *Tax Filing Season: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks 1* (Dec. 2014). In light of the additional cuts made in the IRS’s budget for FY 2015, the overall budget reduction since FY 2010 now comes to about \$1.2 billion.

85 *Review of the President’s Fiscal Year 2015 Funding Request for the Department of the Treasury and the Internal Revenue Service: Hearing Before the Subcomm. On Financial Services and General Government of the Senate Committee on Appropriations*, 113th Cong. (2014) (statement of J. Russell George, Treasury Inspector General for Tax Administration).

86 See IRS Oversight Board, *FY 2015 IRS Budget Recommendation Special Report* (May 2014), at <http://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20FY2015%20Budget%20Report-FINAL.pdf>.

87 IRS Oversight Board News Release, *Vast Majority of Taxpayers Still Have No Tolerance for Income Tax Cheating; Solid Majority Trust IRS and Support Additional Funding* (Dec. 8, 2014), at <http://www.treasury.gov/IRSOB/news/Pages/12082014.aspx>.

## CONCLUSION

Since FY 2010, the IRS's budget has been reduced by about 17 percent in inflation-adjusted terms while taxpayer needs have remained high overall and have increased in certain areas. The key reasons for the funding reduction have been sequestration and a mistrust of the IRS after certain significant management mistakes. Notwithstanding these concerns, the National Taxpayer Advocate believes Congress and the IRS have a shared responsibility to ensure that the taxpayers who pay our nation's bills receive the assistance they need when they seek to comply with their tax filing and payment obligations. It is unacceptable that the IRS may only be able to answer about half the calls it receives, that it will not be able to answer any tax-law questions beyond "basic" ones (and none at all beyond April), and that wait times to speak with customer service representatives will average about a half hour. All too often, the message the government is sending to U.S. taxpayers doing their best to comply with the law is, "We're sorry. You're on your own." U.S. taxpayers deserve better.

Whatever concerns may continue to exist about the IRS, we urge Members of Congress to provide sufficient funding for the IRS to meet taxpayer needs effectively and timely and to make taxpayers' *right to quality service* more than a mere distant aspiration.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress take the following actions:

1. In the short term, carefully monitor taxpayer service trends and ensure that the IRS receives the oversight and funding it requires to meet the needs of U.S. taxpayers.
2. Over the longer term, undertake comprehensive tax reform to reduce the complexity of the Internal Revenue Code and the associated compliance burdens it imposes on taxpayers.

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#2**TAXPAYER SERVICE: Due to the Delayed Completion of the Service Priorities Initiative, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage & Investment Division

**DEFINITION OF PROBLEM**

The National Taxpayer Advocate believes that when taxpayers are attempting to comply with laws that require them to turn over a significant portion of their incomes to pay our nation's bills, they have a right to expect that their government will take their telephone calls and answer their letters. The IRS agrees and included the *right to quality service* as a fundamental taxpayer right in its recent adoption of a taxpayer bill of rights.<sup>1</sup> The National Taxpayer Advocate is concerned, however, that the ongoing cuts to the IRS's budget in fiscal years (FY) 2010–FY 2014<sup>2</sup> have resulted in an unacceptably poor level of taxpayer service, a problem that will only be exacerbated in FY 2015.<sup>3</sup>

For FY 2015, the IRS is projecting it will be able to answer only about 50 percent of the telephone calls it receives from taxpayers seeking to speak with a telephone assistant, and it projects that those taxpayers lucky enough to get through “could easily wait 30 minutes or more for limited service.”<sup>4</sup> This falls woefully short of the service that taxpayers deserve.

In response to these concerns, the Wage & Investment (W&I) Division and the Taxpayer Advocate Service (TAS) are collaborating on the development of a ranking methodology for the major taxpayer service activities offered by W&I. The new methodology will take taxpayer needs and preferences into account while balancing them against the IRS's need to conserve limited resources, thus enabling the IRS to make resource allocation decisions that will optimize the delivery of taxpayer service activities given resource constraints.<sup>5</sup> Congress will also be able to use the results of this methodology to determine whether it is adequately funding core taxpayer service activities. But limitations imposed by the lack of available data have delayed implementation, and it is unclear whether the IRS will devote the resources necessary to complete development of the methodology. In the absence of this or a similar methodology, the IRS lacks a principled basis for making the difficult resource allocation decisions necessitated by today's tight budget environment.

- 1 See IRS News Release, IR-2014-72, IRS Adopts “Taxpayer Bill of Rights”; 10 Provisions to Be Highlighted on IRS.gov, in Publication 1 (June 10, 2014), available at <http://www.irs.gov/uac/Newsroom/IRS-Adopts-Taxpayer-Bill-of-Rights:-10-Provisions-to-be-Highlighted-on-IRSgov,-in-Publication-1>.
- 2 The FY 2014 funding level of 11.3 billion is slightly above the 11.2 billion FY 2013 funding level, but is still significantly below the FY 2010 12.1 billion funding level. See Department of the Treasury, Budget-in-Brief, at <http://www.treasury.gov/about/budget-performance/budget-in-brief/pages/default.aspx> (available for each fiscal year).
- 3 For an in-depth discussion of the impact of IRS budget cuts on taxpayer service, see Most Serious Problem: *Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, *supra*.
- 4 Email from Commissioner Koskinen to All Employees, *Fiscal Year 2015 Funding* (Dec. 17, 2015).
- 5 We use the word “optimize” to mean that the ranking methodology will provide the IRS with a rigorous way to select the combination of competing taxpayer service initiatives that maximizes the “value” of service delivery given available resources.

## ANALYSIS OF PROBLEM

### The IRS Rationale for Recent Deep Cuts to Taxpayer Service is Unclear.

Since FY 2010, the IRS budget has been cut by ten percent, resulting in an ongoing erosion in IRS taxpayer service delivery, and culminating in a number of major cuts the IRS made to taxpayer services in FY 2014:<sup>6</sup>

- The IRS had fewer Customer Service Representatives on the phones to answer questions;
- IRS assistors, both on the phones and at the taxpayer assistance centers (TACs), only answered tax law questions during the filing season even though millions of taxpayers get extensions and do not file until later in the year;
- The IRS limited the scope of questions answered to the most “basic” taxpayer questions;
- The IRS ended tax return preparation services at its TACs; and
- The IRS had fewer TACs in operation.

In response to these budget cuts, the IRS has come under scrutiny by external oversight organizations who have questioned the IRS’s rationale for its budget decisions. They have not been satisfied with the IRS’s response to their inquiries.

In a recent review of the IRS’s provision of face-to-face services, the Treasury Inspector General for Tax Administration (TIGTA) found that the IRS did not have a rigorous methodology for identifying how best to make service cuts affecting face-to-face services, stating:

The IRS eliminated or reduced services at Taxpayer Assistance Centers as part of its Fiscal Year 2014 Service Approach ... The reduction in service was implemented without completing the required taxpayer burden risk evaluation for the taxpayers most likely to visit a Taxpayer Assistance Center, such as low-income, elderly, and limited-English-proficient taxpayers ... For example, taxpayers’ additional travel costs, wait times, and access to volunteer tax return preparation sites were not analyzed ...<sup>7</sup>

TIGTA recommended that the IRS:

Continue working with the National Taxpayer Advocate to complete the Service Priority Project Initiative as well as coordinate the inclusion of Taxpayer Assistance Center services in future surveys that can be used with the Taxpayer Choice Model to obtain data on the services that are most important to taxpayers.

Similarly, when the Government Accountability Office (GAO) conducted its annual review of the IRS filing season, it found the IRS did not have an effective plan for analyzing service changes:

While IRS collected some data that it could use to evaluate effectiveness, it did not develop plans to analyze the data or track it in a way that would allow officials to draw causal connections and develop valid conclusions about the effectiveness of its 2014 service changes.<sup>8</sup>

6 See Most Serious Problem: *Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, *supra*.

7 See TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established*, 5-6 (June 27, 2014).

8 See GAO, GAO-15-163, *TAX FILING SEASON: 2014 Performance Highlights the Need to Better Manage Taxpayer Service and Future Risks*, 22 (Dec. 2014).

As discussed below, W&I is collaborating with TAS on the Service Priorities Project. The project team is developing a tool that will provide the IRS with better information to make budget allocation decisions. Development of the ranking tool has been delayed, however, due to the lack of available data needed to fully populate the ranking tool. Recently, the IRS Oversight Board questioned TAS at length on the goals and status of the Service Priorities Project, emphasizing the need for the IRS to have a methodology to inform its taxpayer service budget allocation decisions.<sup>9</sup>

### Automation Is Not a Complete Solution.

To address ongoing budget pressures, the IRS is increasingly turning away from personal service toward automation, and it is clear that cost-effective innovations could yield improvements in taxpayer service. For example, the IRS allows taxpayers to conduct simple actions through IRS.gov, but taxpayers cannot use the site for tasks such as:

- Correcting computational errors;
- Checking account status; or
- Obtaining prior year return information immediately.

By requiring a taxpayer to write, call, or visit a TAC to complete these tasks, the IRS creates a higher volume of calls, correspondence, and TAC visits, leading to lower levels of service for each of these service channels.

Moving tasks to the Internet would enable computer-savvy taxpayers to use this channel for these actions and could reduce stress on IRS walk-in, telephone and correspondence resources, allowing IRS assistors to focus on taxpayers who need and prefer the TACs, the phone or correspondence.

While automated options are an important component of a comprehensive taxpayer service strategy, the IRS cannot rely solely on these options to close gaps. As the tax code grows more complex, taxpayer issues become increasingly difficult and less suitable for automation. Additionally, IRS research shows that taxpayers prefer personal service for some activities, and that certain segments of the taxpaying public are unable or unwilling to use automation.

... taxpayers report they use IRS.gov most often to complete transactional tasks (*i.e.*, tasks that require minimal in-person assistance, such as obtaining a form or publication). However, when responding to a notice or obtaining payment information, taxpayers said that they are more likely to call the IRS toll-free telephone lines....Research also suggested that age, income, and education are correlated to taxpayer behavior, and recent findings show that taxpayers with lower household incomes reported higher use of non-web-based IRS service channels than taxpayers in higher income households ... Low income, limited English proficient (LEP), and elderly taxpayers tend to report a somewhat higher preference for the TAC channel and a lower preference for the electronic channel than the majority of taxpayers as a whole ... Low income and LEP taxpayers report using the telephone channel more than the overall taxpaying population.<sup>10</sup>

9 IRS Oversight Board Operations Committee Meeting (Dec. 2, 2014). See also follow-up email from the IRS Oversight Board received on Dec. 11, 2014, requesting additional information on the Service Priorities Project ranking model (on file with author).

10 See IRS, *The Taxpayer Assistance Blueprint: Taxpayer Service Improvements: October 2012 to September 2013* 3 (March 24, 2014).

As discussed below, implementation of the Service Priorities ranking methodology will enable the IRS to identify a proper balance between automated and personal service delivery.

### The Service Priorities Project Can Help Optimize Service Delivery.

In response to the National Taxpayer Advocate's concerns about the erosion of taxpayer service delivery, the W&I Division and TAS are collaborating on an initiative, the Service Priorities Project, which will enable the IRS to make resource allocation decisions that will optimize the delivery of taxpayer service activities given resource constraints. Congress will also be able to use the results of this methodology to determine whether it is adequately funding core taxpayer service activities. The implementation of this approach is particularly urgent in light of today's funding environment for taxpayer service.

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The IRS included the right to quality service as a fundamental taxpayer right in its recent adoption of a taxpayer bill of rights. The National Taxpayer Advocate is concerned, however, that the ongoing cuts to the IRS's budget in fiscal years 2010–2014 have resulted in an unacceptably poor level of taxpayer service, a problem that will only be exacerbated in fiscal year 2015.

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The project team is developing a ranking methodology for IRS taxpayer services that takes taxpayer needs and preferences into account. The methodology will value each of the major taxpayer services offered by the IRS from both the government's and the taxpayers' perspective. The IRS will be able to use this ranking methodology to make resource allocation decisions based on highest valued services in the face of budget or staffing constraints.

The methodology measures "value" using separate sets of criteria for taxpayers and the IRS. This is necessary because taxpayers and the IRS have different priorities. The IRS is concerned with conserving resources, especially in a tight budget environment.<sup>11</sup> Taxpayers need services that will enable them to understand their tax obligations and resolve tax issues without imposing undue burden. Frequently, these needs are best met by personal services that are more costly to the IRS than automated services, such as internet based services.

The methodology assigns a score to each initiative that reflects its overall value based on an appropriate balance between criteria that weigh the value of the initiative to the IRS and to the taxpayer.<sup>12</sup> The IRS can use these scores to choose between competing initiatives and identify a proper balance between automated and personal service delivery.

### Service Priorities Project Status and Challenges

TAS has recently held a number of conference calls with W&I Research to discuss the proposed ranking methodology and the steps needed to complete development of the ranking tool. TAS and W&I appear to have informal agreement on the proposed methodology, but some data availability issues still need to be resolved.

The project team identified a number of "data gaps" while attempting to do a trial ranking using a prototype ranking tool and available data. Some of these "data gaps" can be filled by tax year 2013 data that has recently become available, but some known gaps remain. TAS Research and W&I Research have informally agreed to conduct another trial ranking using the new 2013 data. We anticipate completing

11 For a discussion of the current IRS funding environment see Most Serious Problem: *Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, *supra*.

12 For a more complete discussion of the ranking methodology, see National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 57-66 (Research Study: *The Service Priorities Project: Developing a Methodology for Optimizing the Delivery of Taxpayer Services*).

this ranking in early 2015. At that time the project team will identify all remaining data needs and TAS will need to negotiate an agreement with W&I to meet those needs.

## CONCLUSION

The National Taxpayer Advocate urges W&I to work with TAS to complete the research and data collection necessary to make the ranking tool effective as expeditiously as possible. While populating the tool will require the IRS to make additional investments in a time of severe resource constraints, the tool will provide the kind of information the IRS needs to inform the difficult resource allocation decisions that severe resource constraints impose. The tool will also position the IRS to make better investment decisions in the future to reach its goal of providing the world-class taxpayer service that taxpayers deserve.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Complete the ranking process with the newly available tax year 2013 data and identify all steps needed to fully populate the ranking tool.
2. Develop and execute a memorandum of understanding with the National Taxpayer Advocate to document the steps needed to complete development of the Service Priorities Project ranking tool.
3. Incorporate the ranking tool and methodology into plans currently under development for the Services on Demand initiative.<sup>13</sup>

<sup>13</sup> The Services on Demand Initiative has the goal of developing a multi-year plan to build “A tax administration ecosystem that delivers tailored efficient services where, when, and how customers should be served.” Services on Demand Executive Brief not currently available for distribution (June 2014).

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## IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance

### RESPONSIBLE OFFICIALS

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 Sunita B. Lough, Commissioner, Tax Exempt and Government Entities Division  
 Debra Holland, Commissioner, Wage and Investment Division

### DEFINITION OF PROBLEM

The Internal Revenue Restructuring and Reform Act of 1998 (RRA 98) required the IRS to replace its geographic-based structure with organizational units serving groups of taxpayers with similar needs.<sup>1</sup> Congress mandated that the IRS change its organizational structure but did not require the IRS to eliminate its physical local presence or centralize its employees in certain locations. While the new taxpayer-based structure has produced some benefits, the elimination of a functional geographic presence, with IRS employees understanding the needs and circumstances of a specific geographic economy, may harm taxpayers and erode compliance. Maintaining a local presence in both service and enforcement operations is important because such presence enables the IRS to:

- Better understand local economic, social, and cultural conditions and tailor initiatives accordingly to maximize voluntary compliance;
- Identify local variations of nationwide compliance problems;
- Identify and address significant local compliance problems that do not show up nationwide and are unique to a particular local environment; and
- Put a local, human face on the IRS organization through the presence of employees who live in the communities and interact with taxpayers on a day-to-day basis.

By virtually eliminating geographic presence after RRA 98, the IRS has created the following concerns:

- **Increased Taxpayer Burden May Decrease Compliance.** Reduced geographic presence increases taxpayer burden and can lead to reduced compliance.
- **One Size Does Not Fit All Taxpayers.** The IRS does not tailor service or enforcement initiatives to the needs of taxpayers in different regions, which violates the taxpayer's rights to *quality service* and *a fair and just tax system*.
- **Missed Compliance Opportunities.** Centralized compliance initiatives miss chances to identify and address noncompliance specific to a geographic region.
- **Erosion of Taxpayer-Based Structure Since Restructuring.** The taxpayer-based structure has eroded since RRA 98 implementation.

<sup>1</sup> Internal Revenue Service Reform and Restructuring Act of 1998 (RRA 98), Pub. L. No. 105-206, §§ 1001(a)(1) - (3) (1998).

- **The IRS Can Learn From the Experience of Other Taxing Jurisdictions.** For example, Her Majesty's Revenue and Customs (HMRC) in the United Kingdom has taken an approach to taxpayer service and enforcement that combines the expertise of centralization with the ability to reach out to taxpayers on a local level.<sup>2</sup>
- **Congress Did Not Mandate the Elimination of Local Presence.** The IRS can retain its taxpayer-based structure and still maintain local presence.

## ANALYSIS OF PROBLEM

### Background

#### *Geographic Presence Promotes Voluntary Compliance.*

The U.S. tax system is built on voluntary compliance. The IRS structure should enable the IRS, through its service and enforcement activities, to influence taxpayers to voluntarily comply. Encouraging voluntary compliance is the most cost-effective approach for the government in the long term and is less harmful and intrusive to taxpayers.

Research has shown that to improve tax compliance, one-size-fits-all enforcement is less effective than a “tax morale” model of tax administration. The tax morale model uses traditional enforcement techniques such as penalties and audits, but emphasizes taxpayers’ internal motivations and develops more individualized methods to match differing attitudes and behaviors of different types of taxpayers.<sup>3</sup>

For the 2012 and 2013 Annual Reports, the Taxpayer Advocate Service (TAS) developed and administered a survey to a national sample of sole proprietors to determine the factors that influence compliance behavior in this population. TAS also identified geographic communities where a disproportionate number of taxpayers were deemed to be either high or low compliant. Among many other findings, the studies found that respondents from low-compliance communities were suspicious of the tax system and its fairness. Those in the low-compliance group were clustered in geographic communities while those in the high-compliance group were more widely dispersed. The low-compliance group also reported more participation in local institutions. The research found that norms of belief and behavior, particularly local norms, were the most influential factors of tax compliance.

Accordingly, the research suggests the IRS should retain a local presence and conduct outreach and education events, particularly in low compliance communities.<sup>4</sup> Therefore, to maximize voluntary compliance, a one-size-fits-all approach may not be ideal. In fact, it seems to run counter to the IRS’s goals of fostering voluntary compliance and combatting noncompliance.

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The IRS consolidated 33 geographically dispersed lien units into a single centralized unit in 2005, virtually eliminating taxpayers’ ability to walk into an IRS office and obtain an immediate release of a lien.

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2 HM Revenue and Customs News, *HMRC Comes Out of the Office to Support Customers Who Need Extra Help* (Feb. 12, 2014); HM Revenue & Customs, *Issue Briefing: Tackling Tax Evasion* (Jan. 2014).

3 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2 138-50 (Research Study: *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

4 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 60-61 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*). Geographers have classified regions of the U.S. based on local history, values, behavior, and culture. See Colin Woodard, *American Nations: A Hist. of The Eleven Rival Regional Cultures of No. Amer.* (N.Y.: Viking, 2011).

### *The IRS Moved from Geographic Presence Model to Centralization After the 1998 Restructuring.*

Prior to reorganization, the IRS was comprised of 33 districts and ten campuses (then called service centers). Each of these 43 organizations reported to a director who was charged with administering the entire tax code for every kind of taxpayer—from low income individuals to high income businesses, with simple and complex problems, from taxpayer outreach and education to criminal investigation—within his or her district or campus. All of these units were geographically based and functionally separate, with multiple management layers. Four regional offices and a national office conducted oversight of these districts.<sup>5</sup>

Congressional hearings in late 1997 uncovered a wide array of inconsistencies among districts, inefficiencies, and deficiencies in taxpayer service and enforcement practices, which Congress attributed in part to the geographically based structure.<sup>6</sup> The hearings prompted the enactment of RRA 98, which required the IRS to “eliminate or substantially modify the existing organization based on a national, regional, and district structure” and to “establish organizational units serving particular groups of taxpayers with similar needs.”<sup>7</sup> Congress also directed the IRS to “place a greater emphasis on serving the public and meeting taxpayers’ needs.”<sup>8</sup> Taxpayers are now classified as belonging to one of four operating divisions, each nominally charged with end-to-end responsibility for serving that particular group of taxpayers. Theoretically, this structure benefits taxpayers because it enables the IRS to gain a better understanding of the particular needs of each group and develop procedures accordingly.<sup>9</sup> However, it can also mean that taxpayers with the same issue receive different treatment depending on the operating division, or even campus, handling their cases.<sup>10</sup> Moreover, taxpayers with the same problem, but with specific needs because of localized community conditions, now work with IRS employees on the other side of the country who have no knowledge or understanding of those conditions. Finally, as we discuss below, the stated goals of the 1998 reorganization have been considerably undermined by later IRS staffing and policy decisions.

### **Reduced Geographic Presence Increases Taxpayer Burden and May Decrease Voluntary Compliance.**

While the IRS is obligated to enforce complex tax laws, it does have the ability to simplify administrative procedures and make assistance accessible to all taxpayers. Taxpayers’ inability to obtain information and

5 See IRS Document 11052, IRS Organization Blueprint 2000 1-11, Figure 1-2 (Rev. 4-2000).

6 See *Report of the National Commission on Restructuring the Internal Revenue Service: Hearing Before Subcomm. on Oversight of the H. Comm. on Ways and Means 105th Cong.* (July 24, 1997). See also *IRS Restructuring: Hearings Before the S. Comm. on Finance*, 105th Cong. (Jan. 28-29, 1998; Feb. 5, 11, and 25, 1998); National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* (1997).

7 RRA 98, Pub. L. No. 105-206, § 1001(a) (1998).

8 Pub. L. No. 105-206 § 1002 (1998).

9 For more information about the rationale and benefits of the IRS structure after RRA 98, see *Treasury Tax Court Nominations: Hearing Before the S. Comm. on Finance*, 105th Cong. (Jan. 28, 1998) (statement of Charles O. Rossotti, IRS Commissioner).

10 See, e.g., National Taxpayer Advocate 2004 Annual Report to Congress 132-142 (Most Serious Problem: *Inconsistent Campus Procedures*); *Annual RRA '98 Joint Hearing on IRS Progress: Hearing Before J. Comm. on Tax'n* (May 3, 2000) (statement of Charles O. Rossotti, IRS Commissioner) (“Each operating division will be responsible for creating and executing business practices and strategies to meet those needs, and managers at all levels will be expected to be knowledgeable in the substantive problems and issues that arise in administering the tax law in their respective divisions.”) (Emphasis added); *Treasury Tax Court Nominations: Hearing Before the S. Comm. on Finance*, 105th Cong. (Jan. 28, 1998) (statement of Charles O. Rossotti, IRS Commissioner). In response to RRA 98, the IRS established the following four taxpayer-based operating divisions: (1) Wage and Investment Division (W&I); (2) Small Business/Self-Employed Division (SB/SE); (3) Tax Exempt and Government Entities (TEGE) Division; and (4) Large and Mid-Size Businesses (LMSB), which became the Large Business and International Division (LB&I) in 2010. IRS, *IRS Realigns and Renames Large Business Division, Enhances Focus on International Tax Administration*, IR-2010-88 (Aug. 4, 2010).

resolve tax issues by talking to a live IRS employee will certainly impact their ability and willingness to comply. By reducing services at Taxpayer Assistance Centers (TACs), centralizing examination and collection functions, and reducing the level of service on the phones, the IRS is essentially setting the taxpayer up to fail.<sup>11</sup> Even in the age of technological advances, there are still limited options for substituting face-to-face or local interaction with some taxpayer populations. The reduced geographic footprint is also a significant issue for taxpayers living abroad, as the IRS has decreased the number of tax attaché posts in foreign cities from 15 to three—even though the number of individual international taxpayers has increased 50 percent in the past five years alone.<sup>12</sup>

The reduced geographic footprint in enforcement activities is equally burdensome to taxpayers. Some states have neither an IRS Appeals Officer nor a Settlement Officer, and the number of states without these employees has grown from nine in 2011 to 12 in 2014. The IRS consolidated 33 geographically dispersed lien units into a single centralized unit in 2005, virtually eliminating taxpayers' ability to walk into an IRS office and obtain an immediate release of a lien.<sup>13</sup>

### **One Size Does Not Fit All Taxpayers—The IRS Does Not Tailor Service or Enforcement Initiatives to Meet the Particular Needs of Taxpayers in Different Geographic Regions.**

While the post-RRA 98 IRS is built around categories of taxpayers, the IRS has made no real effort to tailor service or enforcement initiatives to meet the particular needs of taxpayers based on their geographic locations. Failure to maintain a local presence infringes upon the taxpayer's *right to quality service*, whereby the taxpayer has the right to receive clear, easily understandable communications from the IRS. It also infringes upon the taxpayer's right to a *fair and just tax system*, because the taxpayer has the right to expect the system to consider facts and circumstances that might affect his or her underlying liabilities, ability to pay, or ability to provide information timely.<sup>14</sup> National "one-size-fits-all" service and enforcement policies for each category of taxpayer and the centralization of much IRS activity into remote "campuses" means the IRS is not addressing the particular attributes of local taxpayer populations. Therefore, not only will the IRS potentially violate the taxpayers' rights but the service and enforcement initiatives designed at the national level may vary in effectiveness across geographic lines.

Localized outreach and education have all but disappeared. For example, the Small Business/Self-Employed division (SB/SE), which serves approximately 65 million taxpayers, has no outreach and education employees in 13 states, plus the District of Columbia. In addition, the Wage and Investment division (W&I), which is responsible for helping approximately 126 million individuals understand and comply with their tax obligations, devotes about six percent of its outreach and education budget to

11 See National Taxpayer Advocate 2013 Annual Report to Congress 20-39 (Most Serious Problem: *IRS Budget: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*).

12 National Taxpayer Advocate 2009 Annual Report to Congress 137; National Taxpayer Advocate 2013 Annual Report to Congress 205; Memorandum from Douglas W. O'Donnell, Acting Deputy Commissioner Large Business and International Division, to LB&I Commissioner, *Beijing Post Closure* (Oct 16, 2014).

13 See Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *infra*; see also National Taxpayer Advocate 2006 Annual Report to Congress 130.

14 For more information about these and other taxpayer rights, see IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights/Taxpayer-Bill-of-Rights-Channel-Page#service>.

Localized outreach and education have all but disappeared. For example, the Small Business/Self Employed division, which serves approximately 65 million taxpayers, has no outreach and education employees in 13 states, plus the District of Columbia.

activities that involve face-to-face contact with taxpayers.<sup>15</sup> Despite the trend to reduce local outreach and education resources, the National Taxpayer Advocate urges the IRS, when designing an outreach and education campaign, to give significant attention to local culture and how different messages will be received across geographic lines

Without local expertise, it is nearly impossible for the IRS to understand and address the distinct attributes of local taxpayer populations. Some taxpayers may not require face-to-face assistance but instead need local personnel who understand their particular environment or occupation. IRS employees should have knowledge of local issues and know the demographics and normative culture of local populations.<sup>16</sup>

As illustrated in the Appendix to this Most Serious Problem, the IRS significantly reduced staffing in the local offices between 2001 and 2014. At the same time, the IRS increased staffing at the campuses, due to centralization.

### Centralized Compliance Initiatives Miss Opportunities to Identify and Address Noncompliance Specific to a Geographic Region.

Centralized compliance initiatives may miss chances to target strategies to locally noncompliant groups of taxpayers.<sup>17</sup> Significant local noncompliance may not even show up on the radar at a national level. In contrast, Local Compliance Initiative Projects (CIPs)<sup>18</sup> are likely to have a greater effect on voluntary compliance by cash economy businesses than seemingly random examinations.<sup>19</sup>

An example of a successful local initiative is one that took place in the early 1990s in Alaska, where the IRS used a “Compliance 2000” project to address noncompliance by commercial fishermen, which resulted from confusion as well as community norms and attitudes. With the assistance of local authorities, the IRS compared a list of fishing permit and license holders with existing data to identify nonfilers.

15 IRS, Individual Returns Transaction File, IRS Compliance Data Warehouse (Tax Year (TY) 2013 returns filed through Oct. 2014); IRS HRRC, Report of SB/SE Job Series 0526, Stakeholder Liaison Field Employees as of November 1, 2014 (Nov. 19, 2014) (13 states include Alaska, Delaware, Hawaii, Kentucky, Mississippi, Montana, North Dakota, Nebraska, New Hampshire, South Dakota, Vermont, West Virginia, Wyoming); National Taxpayer Advocate 2012 Annual Report to Congress 319 (Most Serious Problem: *The IRS is Substantially Reducing Both the Amount and Scope of Its Direct Education and Outreach to Taxpayers and Does Not Measure the Effectiveness of Its Remaining Outreach Activities, Thereby Risking Increased Noncompliance*).

16 See National Taxpayer Advocate 2011 Annual Report to Congress 273-335 (Most Serious Problem Category: *Diversity Issues*).

17 See, e.g., National Taxpayer Advocate 2009 Annual Report to Congress 168 (Most Serious Problem: *The IRS Exam Function is Missing Opportunities to Maximize Voluntary Compliance at the Local Level*); National Taxpayer Advocate 2009 Annual Report to Congress 185 (Most Serious Problem: *The IRS Does Not Have a Significant Audit Program Focused on Detecting the Omission of Gross Receipts*); National Taxpayer Advocate 2004 Annual Report to Congress 220 (Most Serious Problem: *IRS Examination Strategy*).

18 CIP procedures are followed when groups of returns with the same areas of potential noncompliance are selected and forwarded for examination in a project, either in the campus or area office. CIPs are characterized by the use of internal and external data to identify and quantify areas of noncompliance. They usually involve a study, survey, or other analysis of a group of individuals such as those involved in a specific economic activity, undertaken to identify, measure, or analyze compliance with the tax laws. CIPs are often multi-functional in their approach. IRM 4.19.10.2.5, *SB/SE Compliance Initiative Project (CIP) Procedures*, (Jan. 1, 2011).

19 Underreported income from the “cash economy”—taxable income from legal activities that is not subject to information reporting or withholding—is probably the single largest component of the tax gap, likely accounting for an estimated \$120 billion per year. IRS, Tax Gap for Tax Year 2006, Overview, Chart 1. See National Taxpayer Advocate 2007 Annual Report to Congress 35 (Most Serious Problem: *The Cash Economy*); National Taxpayer Advocate 2005 Annual Report to Congress 55 (Most Serious Problem: *The Cash Economy*). National Taxpayer Advocate 2004 Annual Report to Congress 220 (Most Serious Problem: *IRS Examination Strategy*).

Local IRS officials also proposed changes to federal and state laws to reduce confusion, promote compliance, and facilitate collection. The IRS simultaneously launched extensive outreach and education efforts in remote fishing villages and on fishing vessels, which included the preparation of returns and training local volunteers to assist taxpayers. The IRS also enlisted the help of local community organizations, which hired a Yupik speaker full-time to help local residents with tax problems, provided loans to help fishermen pay delinquencies, and helped to publicize the IRS's compliance initiatives.

The Alaska-based compliance initiative brought in over 1,000 unfiled returns and significantly improved voluntary compliance among the target population, reducing nonfiling from 13.1 percent in tax year 1990 to 9.2 percent in tax year 1992.<sup>20</sup> This shows how a local compliance effort can identify and address geographically-based noncompliance where a national or centralized compliance initiative would not. It also illustrates the need for a cross-functional approach with exam, collection, outreach and education, and TAS employees collaborating to develop and implement a comprehensive strategy.

Despite evidence that CIPs can generate valuable information and results, SB/SE Field Exam only had five open local CIPs (Part 2) as of November 10, 2014.<sup>21</sup>

### The Taxpayer-Based Structure Has Eroded Since the IRS Implemented RRA 98.

The taxpayer-based structure required by RRA 98 is beneficial to taxpayers but has eroded over time. After enactment of the law, both service and enforcement activities were initially organized around taxpayer populations. For example, each operating division (OD) had stakeholder relations groups. In addition, the enforcement procedures were initially specific to the type of taxpayer. However, the IRS has deviated from the goal of providing end-to-end service by taxpayer type in an attempt to achieve efficiencies. Notably, the IRS has charged the W&I division with performing key servicewide operations such as:

- Processing returns;
- Staffing telephone lines;
- Managing taxpayer accounts;
- Publishing all forms, instructions, and publications; and
- Maintaining the IRS's e-services.<sup>22</sup>

In addition, traditional local exam and collection work has been increasingly directed to remote centralized SB/SE sites for efficiency purposes.<sup>23</sup> As a result, the IRS now has large, remote organizations and little local presence. It retains virtually no local compliance initiatives, despite evidence that compliance

20 National Taxpayer Advocate 2008 Annual Report to Congress 177-78.

21 SB/SE Field has seven areas working CIPs (as opposed to one for each district pre-RRA 98). In addition, SB/SE Exam had 62 Part 1 CIPs open as of November 4, 2014. IRS, CIP National Office Database, SB/SE Field Open CIPs (Nov. 4, 2014). A Part 1 CIP is limited to fewer than 50 taxpayer contacts. IRM 4.17.4.1.1(2), *Types of CIP Requests*, (Feb. 25, 2010). A Part 2 CIP is an expanded initiative when there is a documented demonstrated level of non-compliance found on an initial Part 1 CIP. IRM 4.17.4.1.1(3), *Types of CIP Requests*, (Feb. 25, 2010). In addition, LB&I had 12 open CIPs as of December 18, 2014. IRS response to TAS fact check (Dec. 18, 2014).

22 National Taxpayer Advocate 2010 Annual Report to Congress 49-70 (Most Serious Problem: *The Wage & Investment Division Is Tasked With Supporting Multiple Agency-Wide Operations, Impeding its Ability to Serve its Core Base of Individual Taxpayers Effectively*).

23 National Taxpayer Advocate Blog, *IRS Correspondence Examinations: Are they really as effective as the IRS thinks?*, available at <http://www.taxpayeradvocate.irs.gov/Blog/irs-correspondence-examinations-are-they-really-as-effective-as-the-irs-thinks>; National Taxpayer Advocate 2012 Annual Report to Congress 381-402 (Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to Resolve Collection Workload More Effectively*).

is driven by community norms.<sup>24</sup> In addition, remote centralization has been made worse by the batch processing approach in which, generally, no one employee is assigned to work a particular case end to end. In other words, no employee is accountable for what happens with that case. This lack of individual accountability undermines both the efficiency and effectiveness benefits of centralization.

An example of how to retain centralization and expertise while still addressing the particular local needs of taxpayers is the way the IRS processes innocent spouse relief claims. Generally, the IRS has centralized innocent spouse case processing at the Cincinnati Centralized Innocent Spouse Operation (CCISO). This structure is essential for the expeditious handling of these cases. However CCISO will refer the case to an Area office if the case satisfies certain criteria set forth in IRM 25.15.6.1(3).<sup>25</sup>

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**The Alaska-based compliance initiative brought in over 1,000 unfiled returns and significantly improved voluntary compliance among the target population, reducing nonfiling from 13.1 percent in tax year 1990 to 9.2 percent in tax year 1992. This shows how a local compliance effort can identify and address geographically-based noncompliance where a national or centralized compliance initiative would not.**

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### The IRS Can Learn From the Experience of Other Countries.

In the United Kingdom, Her Majesty's Revenue and Customs has acted to meet the needs of taxpayers through a combination of centralization and local presence. HMRC closed its tax offices, called "enquiry centres," in early 2014 and launched a new approach to customer service. Based on the findings from a seven-month pilot, HMRC implemented a national service to bring expert advisers together to resolve multiple issues on a single phone call without transferring the taxpayer to different parts of the organization. The new approach also provides mobile advisors for taxpayers who need face-to-face help. The mobile advisors meet with taxpayers by appointment at a variety of venues, from government and community buildings to a taxpayer's home or business.<sup>26</sup>

HMRC also has a geographic presence in its enforcement activities. For example, since 2011, it has set up more than 60 regional task forces aimed at high-risk sectors, such as markets in London, taxi firms in Yorkshire and the East Midlands, property rentals in several regions, and restaurants in the Midlands.<sup>27</sup>

### The IRS Can Retain its Taxpayer-Based Structure and Still Maintain Local Presence.

The IRS can retain its national policymaking structure without losing the ability to respond to local conditions and challenges. In RRA 98, Congress did not mandate that the IRS completely eliminate its local presence. It only directed the IRS to reorganize in a taxpayer-based model.

24 See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2 60-61 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

25 IRM 25.15.6.1 (3), *Overview: Purpose of Manual* (Mar. 21, 2008). See also IRM 25.15.8.5.3.2, *CCISO Processing* (Nov. 13, 2014) (transferring collection cases with "unusual situations" to field examination). In addition, the LB&I Division restructured in 2012 to retain its six industry organizational structure but to realign the industries using a geographic model. That is, the six industries were realigned so they follow more contiguous geographic boundaries. However, the individual Industry Directors retain responsibility for strategic issues in their industries no matter where the issue is located. IRS Fact Sheet, *Large Business & International (LB&I) Realignment* (May 2012).

26 HM Revenue and Customs News, *HMRC Comes Out of the Office to Support Customers Who Need Extra Help* (Feb. 12, 2014).

27 HM Revenue & Customs, *Issue Briefing: Our Approach to Tax Compliance* (Sept. 2012); HM Revenue & Customs, *Issue Briefing: Tackling Tax Evasion* (Jan. 2014).

The IRS is currently realigning its compliance operations in the W&I and SB/SE Divisions, with the stated goals of increasing organizational efficiencies and improving the agency's ability to quickly identify emerging compliance risks.<sup>28</sup> The IRS even solicited suggestions from all employees. The National Taxpayer Advocate believes the current realignment is an ideal time to reassess the IRS structure to better achieve the goals of RRA 98. The IRS's structure should balance the need for centralization of certain activities and the need for local presence in others. To achieve the goals of RRA 98, the IRS should attempt to maximize the benefits of both the "taxpayer type" model and the geographic presence model and mitigate any associated risks. Accordingly, the IRS should take the following six administrative actions to enhance its local presence while retaining its taxpayer-based structure:

1. **Reinvigorate the Local Compliance Initiative Program.** To accomplish this objective, the IRS must increase local staffing and research in outreach and education, Exam, Collection, and Appeals.<sup>29</sup> The creation of additional local positions should not necessarily cause a net gain in employees, because the IRS can shift campus positions to the field (the IRS can decrease campus staffing through attrition and not filling vacancies). The reinvigorated local presence groups would still report to the operating divisions and have cross-divisional local compliance counsels.<sup>30</sup> Finally, the local groups could propose compliance pilots that include outreach, service, and problem resolution components that would further the National Office goals but with a local flavor.
2. **Introduce videoconferencing for a virtual remote office audit or office collection visit.** Providing taxpayers with the ability to discuss their tax controversies virtually will combine the benefits of centralization and geographic presence. It will also enable remote taxpayers to explain their particular circumstances to a live person working their cases.
3. **Assign one employee to work each case end to end.** The IRS should modify batch-processing procedures so that once the taxpayer has responded, the case is assigned to one employee for its duration. This one employee can hear and consider the taxpayer's unique circumstances, and the IRS can better understand whether to refer that case to the local office.<sup>31</sup>
4. **Re-staff Appeals Officers and Settlement Officers locally.** The IRS should re-staff Appeals Officer and Settlement Officer positions so at least one of each is located and regularly available in every state, the District of Columbia, and Puerto Rico.<sup>32</sup>
5. **Re-staff Local Outreach and Education Positions.** The IRS should increase outreach and education staff for each operating division to ensure that at least one W&I and one SB/SE outreach employee is located in every state, the District of Columbia, and Puerto Rico.

28 See IRS, *IRS to Realign Compliance Operation*, 2014 TNT 196-18, Tax Analysts Tax Notes Today (Oct. 9, 2014); *IRS Looks at Realigning Compliance Operations*, available at <http://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (last visited Dec. 22, 2014), noting that "Generally, this plan would move pre-filing compliance work to W&I and post-filing compliance work for individuals and small businesses to SB/SE."

29 Criminal Investigation is already geographically-based. It is divided into geographic areas throughout the United States—Southern, Northern, and Western. The Director of Field Operations in each area has functional coordination and program oversight responsibilities over criminal investigation activities for that area. In addition, the three geographic areas are further divided into field offices. Each field office has a Special Agent in Charge to direct, monitor, and coordinate the criminal investigation activities within that office's area of responsibility. Several smaller posts-of-duty are located within each field office. See also IRS Criminal Investigation Division (CI), Business Architecture Version 2.0 slides 41-47 (July 30, 2003).

30 While further evaluation is necessary, perhaps the IRS could have 33 cross-BOD local compliance counsels, similar to the old district structure. Alternatively, the structure could entail 32 officials overseeing the compliance counsel and those officials reporting to the national office.

31 See Most Serious Problem: *CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*, *infra*.

32 See Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *infra*; National Taxpayer Advocate 2009 Annual Report to Congress 346-50.

6. **Provide face-to face service through mobile vans in each state.** Similar to HMRC, the IRS should use mobile vans to tour each state on a set schedule, so taxpayers, including those in remote areas, can receive education or face-to-face assistance with tax controversies. The employees in these mobile units would be well-versed in the local culture as well as any issues specific to the local economy.

## CONCLUSION

When implementing the congressional directive to reorganize, the IRS should not have eliminated its local structure. The National Taxpayer Advocate believes the IRS can maintain its current taxpayer-based structure without abandoning a geographic footprint. While the IRS is already realigning its compliance operations in the Wage and Investment and Small Business/Self-Employed Divisions to increase organizational efficiencies, it should reconsider its structure and balance the need for centralization of certain activities and the need for local presence in others.<sup>33</sup> The IRS can modify the current structure to meet taxpayer needs and compliance challenges specific to a certain locale.

## RECOMMENDATIONS

To improve the IRS's geographic presence, the National Taxpayer Advocate recommends that the IRS take the following actions:

1. Reinvigorate the Local Compliance Initiative Program by increasing local staffing and research in outreach and education, Exam, Collection, and Appeals.
2. Introduce videoconferencing for a virtual remote office audit or office collection visit.
3. Modify batch processing procedures so that once the taxpayer has responded, the case is assigned to one employee for the duration of the case.
4. Re-staff Appeals Officers and Settlement Officers locally so that one of each employee is located and regularly available in every state, the District of Columbia, and Puerto Rico.
5. Re-staff local outreach and education positions to bring an actual presence to every state.
6. Provide face-to face service through the use of mobile vans in each state.

<sup>33</sup> See *IRS Looks at Realigning Compliance Operations*, available at <http://www.irs.gov/uac/Newsroom/IRS-To-Realign-Compliance-Operations> (last visited Nov. 20, 2014), noting that "Generally, this plan would move pre-filing compliance work to W&I and post-filing compliance work for individuals and small businesses to SB/SE."

## APPENDIX: A Case Study in Local Presence in Various Regions: Substantial Reduction of Geographic Presence in Local Offices as Compared to the Campuses.

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The impact of the reduced geographic footprint is best told through examples of offices located around the country. We have chosen IRS offices in the state of Wyoming and the New York City borough of Manhattan to illustrate two locations at opposite ends of the spectrum in terms of the volume of taxpayers and type of assistance required. To contrast the staffing trends in these local offices, we have also provided staffing data for the IRS Campus in Kansas City.<sup>34</sup> The data for each of the jurisdictions illustrate the significant changes in staffing from 2001 to 2014 for IRS functions with significant roles in IRS compliance functions and customer service.<sup>35</sup> We have excluded Taxpayer Advocate Service employees and those from Submission Processing, where relevant.

### Background: Total IRS Staffing and Tax Returns.

Over the last 13 years, the IRS experienced a significant drop in staffing. Excluding TAS, IRS employee levels dropped approximately 22 percent since 2001. While staffing dropped, total and individual filings increased between 2001 and 2013 by five percent and 12 percent, respectively.

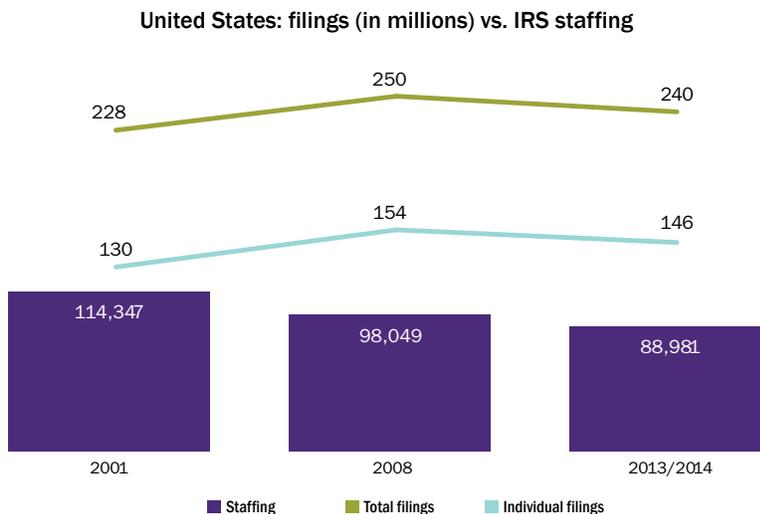
Specifically, there were over 114,000 employees in 2001 and this staffing level dropped by more than 22 percent to fewer than 89,000 in 2014. At the same time, according to the annual IRS data books, taxpayer filings showed growth over the first decade of the 21<sup>st</sup> century, followed by a slightly downward trend in recent years, as displayed in the following chart. Overall, individual filings grew by five percent and total filings grew by 12 percent between 2001 and 2013.

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34 The data only includes specific functions that are mutual to both local offices and the campuses. Thus, we have excluded some functions, such as submission processing, because there is no corollary in the field. We have excluded TAS because, by statute, TAS is required to maintain at least one Local Taxpayer Advocate office in each state. IRC § 7803(c)(2)(D)(i)(I).

35 The staffing data in this discussion was obtained from the IRS Human Resources Reporting Center.

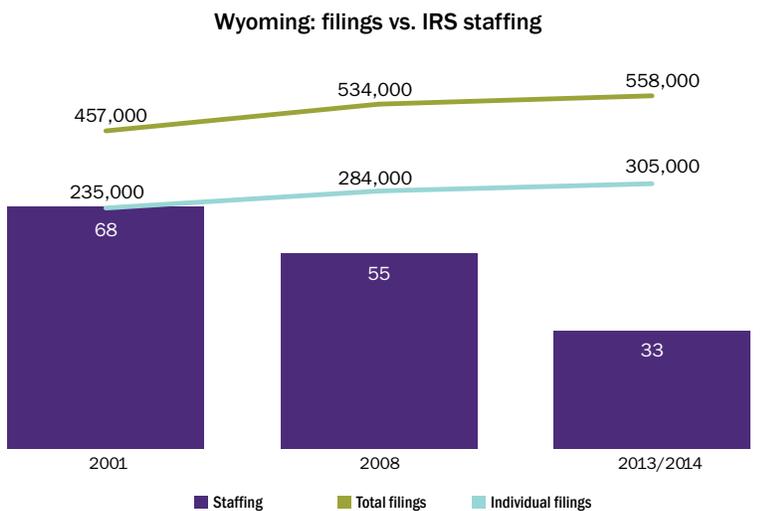
**FIGURE 1.3.1<sup>36</sup>**



**Out West: Significant Drop in Wyoming Staffing.**

The downward trend in staffing is even more pronounced in some states, such as Wyoming, where staffing dropped by 50 percent while total and individual filings increased over the same period by 22 percent and 30 percent, respectively, as displayed in the following chart.

**FIGURE 1.3.2<sup>37</sup>**



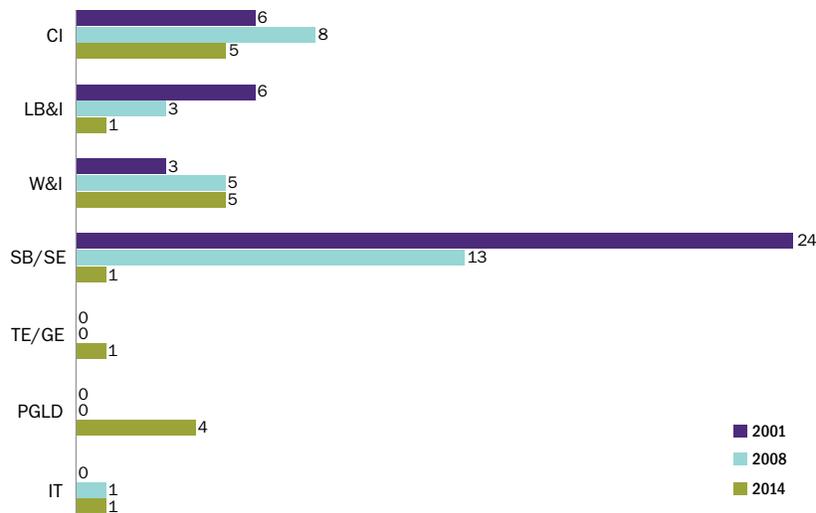
36 Data summarizes total staffing (full time, part time, seasonal and intermittent), excluding TAS, for 2001, 2008 and 2014 from IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were January 27, 2001, January 5, 2008 and October 18, 2014. Filing data from IRS Databooks for 2001, 2008, 2013. Filing data for 2014 will not be available until March, 2015.

37 Data summarizes total staffing (full time, part time, seasonal and intermittent), excluding TAS, for 2001, 2008 and 2014 from IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were Jan. 27, 2001, Jan. 5, 2008 and Oct. 18, 2014. Filing data from IRS Databooks for 2001, 2008, 2013, rounded to the nearest thousand. Filing data for 2014 will not be available until March, 2015.

Focusing on Cheyenne, the state capitol, there was a decrease for most of the operating divisions, as shown in the below graph.

**FIGURE 1.3.3<sup>38</sup>**

**Cheyenne, Wyoming: IRS staffing, 2001-2014**



Notably, SB/SE employees dropped from 24 to one between 2001 and 2014, a decline of 96 percent, despite an increase in small businesses in the Cheyenne area of 10 percent for businesses with less than 100 employees between 2001 and 2011.<sup>39</sup>

**The Big City: Manhattan Also Experienced a Significant Drop in Staffing.**

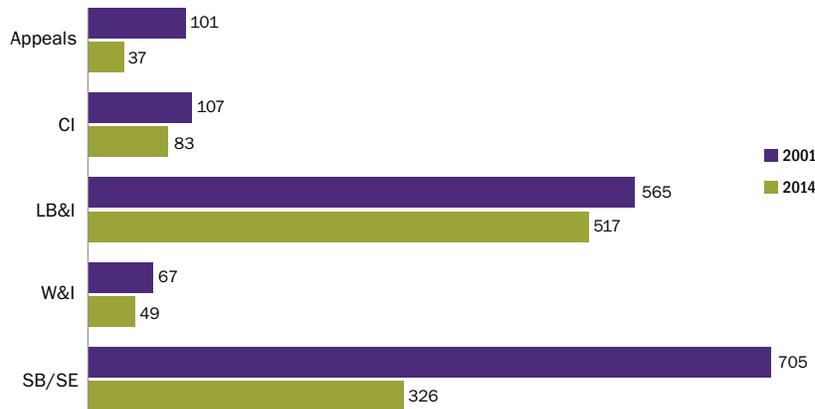
Another example from a much larger metropolitan area, Manhattan, shows that staffing in major operating divisions dropped 34 percent from 2001 to 2014.

38 CI is Criminal Investigation Division; LB&I is Large Business and International Division; W&I is Wage and Investment Division; SB/SE is Small Business/Self-Employed Division; TE/GE is Tax Exempt/Government Entities Division; PGLD is Privacy, Government Liaison and Disclosure; and IT is Information Technology. Staffing data for 2001, 2008 and 2014 from IRS, Human Resources Reporting Center, Post of Duty Building Reports, Workforce Information by Building – Now with Employee Listing Option (using the dates Jan. 27, 2001, Jan. 5, 2008 and Oct. 18, 2014).

39 U.S. Census Bureau, Statistics of U.S. Businesses, Historical Data Tabulations by Enterprise Size, available at [http://www.census.gov/econ/susb/historical\\_data.html](http://www.census.gov/econ/susb/historical_data.html) (last visited Dec. 22, 2014). The number of businesses rose from 13,465 in 2000-2001 to 14,839 in 2010-11.

**FIGURE 1.3.4<sup>40</sup>**

**Manhattan, New York: IRS staffing, 2001 & 2014**



Specifically, although individual filings increased by 12 percent, staffing of Wage & Investment employees decreased by 27 percent. Small business corporations and partnerships increased by 19 and 94 percent, respectively, but SB/SE staffing (which handles both service and enforcement activities with respect to the small business population) decreased by more than 50 percent.

Thus, while staffing significantly decreased in all of the above-displayed operating divisions, total filings of the above-mentioned forms (Forms 1040, 1120, 1120S, and 1065) grew by almost 14 percent in Manhattan between TY 2000 and TY 2013.<sup>41</sup>

**FIGURE 1.3.5, Manhattan filings, tax years 2000-2013**

Form	TY 2000	TY 2007	TY 2013	% Change from 2000 to 2013
Form 1040	1,993,379	2,385,057	2,227,685	12%
Form 1120	79,758	75,396	74,906	-6%
Form 1120S	93,828	107,397	111,700	19%
Form 1065	64,836	104,036	125,734	94%

**To The Middle: Kansas City Campus Experiences a Significant Growth in Staffing.**

The Kansas City campus experienced overall growth, due to centralization. This campus houses, among others, the following operations: Submission Processing, Accounts Management, Correspondence Exam, and Automated Collection System (ACS). The following table shows a drop in campus staffing for most operating divisions, but a significant (23 percent) increase for non-submissions processing staff in Wage &

40 Staffing data for all Manhattan locations, excluding Support and Headquarters positions, 2001 (Jan. 27, 2001) and 2014 (Oct. 18, 2014) from IRS, Human Resources Reporting Center, Post of Duty Building Reports, Workforce Information by Building available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014).

41 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File and Business Returns Transaction File, Tax Years 2000, 2007 and 2013.

Investment.<sup>42</sup> We excluded Submission Processing staff from the campus data for comparison purposes, because there is no counterpart to this function in the local offices in the field.<sup>43</sup> We have included staffing numbers for Overland Park, Kansas (OVP) in the totals because staff from the OVP office moved to the campus during the period under review.

**FIGURE 1.3.6, IRS staffing for Kansas City, 2001 and 2014, Submission Processing excluded**

Operating Division	As of January 27, 2001			As of October 18, 2014			Percent change
	OPK	KC	Total	OPK	KC	Total	
Appeals	0	21	21	0	14	14	-33%
Criminal Investigation	0	58	58	7	20	27	-53%
Large Business and International LB&I (formerly LMSB)	0	35	35	5	1	6	-83%
Small Business/Self-Employed	5	53	58	48	13	61	5%
Wage & Investment	1,350	187	1,537	5	1,888	1,893	23%
<b>Total</b>	<b>1,355</b>	<b>354</b>	<b>1,709</b>	<b>65</b>	<b>1,936</b>	<b>2,001</b>	<b>17%</b>

In contrast, the outlying towns and cities, with few exceptions, experienced steep declines in staffing, between 2001 and 2014.<sup>44</sup>

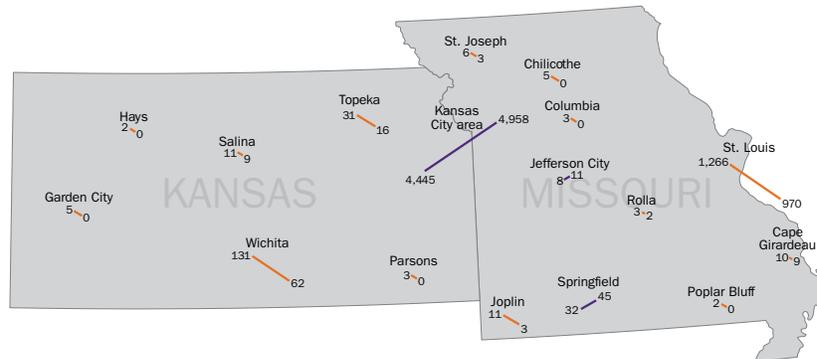
42 Total W&I staff in OVP and KC campus increased from 1,537 on Jan. 27, 2001 to 1,893 on Oct. 18, 2014. IRS, Human Resources Reporting Center (using the dates Jan. 27, 2001 and Oct. 18, 2014).

43 Submission Processing's mission is to receive, process and archive tax and information returns; issue taxpayer notices; process refunds; and account for all tax revenues. See also IRM 21.3.4.8, *Receipt of Tax Returns*, (Jan. 2, 2014).

44 Data summarizes total staffing (Full time, part time, seasonal and intermittent), excluding TAS, for 2001 and 2014 from IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were Jan. 27, 2001 and Oct. 18, 2014.

**FIGURE 1.3.7<sup>45</sup>**

**Decrease in staffing in local offices surrounding Kansas City, 2001-2014**



Notably, Wichita dropped 53 percent and the St. Louis area (St. Louis, Town and Country, Sunset Hills, and Florissant) by 23 percent. Ten locations in Kansas and Missouri had some staffing in 2001, but no staffing at all in 2014.

The increase in W&I staffing can also be seen in the IRS campuses across the country. The following chart compares W&I staffing in Accounts Management and Compliance for all the existing campuses between January 27, 2001 and October 18, 2014.<sup>46</sup>

**FIGURE 1.3.8, W&I Accounts Management and Compliance staff for all IRS campuses<sup>47</sup>**

W&I Function	2001 Staff	2014 Staff	% Change
W&I Accounts Management	8,025	16,655	108%
W&I Compliance	5,456	5,237	-4%
<b>Total W&amp;I AM and Compliance</b>	<b>13,481</b>	<b>21,892</b>	<b>62%</b>

45 Data summarizes total staffing (Full time, part time, seasonal and intermittent), excluding TAS, for 2001 and 2014 from IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were Jan. 27, 2001 and Oct. 18, 2014).

46 In 2001, the IRS had W&I AM and compliance staff in the following campuses: Andover, Atlanta, Austin, Fresno, and Kansas City. In 2014, the IRS had the W&I staff in the following campuses: Andover, Atlanta, Austin, Brookhaven, Cincinnati, Fresno, Kansas City, Memphis, Ogden, and Philadelphia.

47 IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited Nov. 25, 2014). Effective dates were Jan. 27, 2001 and Oct. 18, 2014).

MSP  
#4**APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State****RESPONSIBLE OFFICIAL**

Kirsten B. Wielobob, Chief, Appeals

**DEFINITION OF PROBLEM**

Congress has long recognized that “all taxpayers should enjoy convenient access to Appeals, regardless of their locality.”<sup>1</sup> As a result, Congress required the IRS, among other things, to “ensure that an appeals officer is regularly available within each State.”<sup>2</sup> Recently, in adopting the Taxpayer Bill of Rights (TBOR), the IRS reaffirmed its commitment to a number of related principles including *the right to appeal an IRS decision in an independent forum*, *the right to quality service*, *the right to challenge the IRS’s position and be heard*, and *the right to a fair and just tax system*.<sup>3</sup> All of these fundamental rights are adversely affected when a face-to-face Appeals conference is not readily and conveniently available.

The IRS maintains that this mandate is met by Appeals Officers “riding circuit” (*i.e.*, traveling into the jurisdiction so as to meet with taxpayers in person) at least quarterly in states lacking a permanent Appeals presence.<sup>4</sup> Nevertheless, circuit riding Appeals cases often take an additional six months or more to resolve and have significantly lower levels of agreement than face-to-face Appeals cases conducted in field offices.<sup>5</sup> Appeals’ physical presence in certain states has continued to be restricted or has been eliminated entirely. Almost one quarter of the states (12 out of 50) have no permanent Appeals presence, and this number of states lacking a permanent field office has increased by 33 percent, from nine to 12, since 2011.<sup>6</sup>

The National Taxpayer Advocate has long warned of the dangers to taxpayer rights inherent in such a course of action.<sup>7</sup> Taxpayers in states without an Appeals presence may be forced to travel long distances,

1 S. REP. No. 105-174, at 92 (1998).

2 The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle E, § 3465 (b) (July 22, 1998).

3 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. In particular, *the right to appeal an IRS decision in an independent forum* is explained by TBOR as follows: “Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals’ decision. Taxpayers generally have the right to take their cases to court.”

4 *The U.S.–China Economic Relationship: A New Approach For a New China*, Hearing Before the S. Comm. on Finance, 111th Cong., 69-70 (2010) (testimony of Timothy F. Geithner, Sec. of Treasury). See also National Taxpayer Advocate 2009 Annual Report to Congress 81.

5 See Figures 3 and 4, *infra*.

6 IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited June 27, 2014). The territory of Puerto Rico has also lacked a permanent Appeals office during this time period.

7 See National Taxpayer Advocate 2009 Annual Report to Congress 346-350. See also *Hearing on Filing Season 2012*, Hearing Before the S. Comm. on Finance, 112th Cong. 3-12 (2012) (testimony of Teresa Thompson, Local Taxpayer Advocate, MT).

incur additional expenses, or face delays in obtaining an in-person hearing.<sup>8</sup> Even if they persevere and obtain a face-to-face hearing, their cases may be handled by an Appeals Officer or a Settlement Officer unfamiliar with the local economy or other relevant community issues.<sup>9</sup> Additionally, curtailed face-to-face conferences can make it more difficult for Appeals Officers to gauge the credibility of oral testimony and can cause taxpayers to question the independence and impartiality of Appeals.<sup>10</sup> Videoconferencing could be part of the solution to the lack of Appeals presence; however, it is not a panacea and is no replacement for local knowledge, experience, or presence.

## ANALYSIS OF PROBLEM

### When Passing RRA 98, Congress Expressed its Intent that Taxpayers Should Have Convenient Access To Appeals Regardless of Their Locality.

Congress believed that making Appeals Officers available in each state would provide a place for taxpayers to turn when they disagreed with the IRS.<sup>11</sup> Congress was further convinced that this convenient access was not only an important element of taxpayer rights, but would also contribute to the goal of more timely and efficient resolution of disputes between taxpayers and the IRS.<sup>12</sup> Moreover, Appeals Officers who are well versed in the local industries and economic circumstances prevailing within a particular region are indispensable as a means of preserving both the appearance and the reality of fair and equitable treatment.<sup>13</sup>

As explained by Senator Roth, when adding § 3465 to RRA 98:

With this legislation, we require the agency to establish an independent Office of Appeals—one that may not be influenced by tax collection employees or auditors. Appeals officers will be made available in every state, and they will be better able to work with taxpayers who proceed through the appeals process.<sup>14</sup>

### The IRS's Contention that Circuit Riding Complies With the Mandate of RRA 98 Regarding Ready Access to Appeals Does Not Comport With Reality.

The IRS does not dispute that it is subject to § 3465(b) of RRA 98. Instead, the IRS argues that it meets its obligations by allowing for “circuit riding” on at least a quarterly basis to states lacking a permanent

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- 8 See National Taxpayer Advocate 2009 Annual Report to Congress 346-350. See also *Hearing on Filing Season 2012, Hearing Before the S. Comm. on Finance, 112th Cong. 3-12 (2012)* (testimony of Teresa Thompson, Local Taxpayer Advocate, MT). The terms “in-person” Appeals conferences and “face-to-face” Appeals conferences are used interchangeably and should be distinguished from “virtual face-to-face” Appeals conferences, which the IRS hopes to make available through the use of technology. VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services, *infra*. See also Legislative Recommendation: *Virtual Service Delivery (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet, infra*.
- 9 National Taxpayer Advocate 2009 Annual Report to Congress 76.
- 10 For a suggestion from the National Taxpayer Advocate regarding congressional intervention as a means of solving this problem, see Legislative Recommendation: *Access to Appeals: Require That Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico, infra*.
- 11 See, e.g., 144 CONG. REC. S7639 (1998) (statement of Sen. Jeffords).
- 12 S. Rep. No. 105-174, at 88 (1998).
- 13 National Taxpayer Advocate 2009 Annual Report to Congress 76. See also *Filing Season Update: Current IRS Issues, Hearing before the S. Comm. on Finance, 111th Cong., 18-19 (2010)* (remarks of Sen. Enzi).
- 14 144 CONG. REC. S7622 (1998) (statement of Sen. Roth).

Not only are states without an Appeals post of duty increasing, but the number of Appeals Officers and Settlement Officers located in existing field offices has diminished. Between the summer of 2010 and the summer of 2014, this category of Appeals personnel has dropped by approximately 27 percent, from 817 to 593.

Appeals field office.<sup>15</sup> Additionally, the IRS states that, “Taxpayers are never required to travel out of state for face-to-face meetings unless they prefer meeting in an alternate location as a matter of convenience.”<sup>16</sup>

Doubts persist, however, regarding whether circuit riding satisfies the congressional intent underlying § 3465(b).<sup>17</sup> Circuit riding existed prior to the passage of RRA 98.<sup>18</sup> Nevertheless, Congress felt compelled to require that Appeals Officers be made regularly available in *all* states. Unlike some other aspects of RRA § 3465, which the legislative history explained as a codification of existing IRS procedures, the “regularly available within each State” mandate was presented as a new requirement.<sup>19</sup> Despite this legislative indication that Congress desired more convenient access and local presence than was being supplied by circuit riding, the IRS has expanded the number of states without an Appeals Officer or Settlement Officer, and has contended that circuit riding alone fulfills its post-RRA 98 obligations.

Unsatisfied with this position, Senator Enzi, as part of the fiscal year 2011 Senate Budget Resolution, introduced legislation requiring redeployment of existing IRS resources “to provide at least one full-time Internal Revenue Service appeals officer and one full-time settlement agent in every State.”<sup>20</sup> In connection with this legislation, Senator Enzi explained:

Section 3465(b) of the IRS Restructuring and Reform Act of 1998 states, ‘The Commissioner of the Internal Revenue Service shall ensure that an appeals officer is regularly available within each state,’ yet Wyoming and eight other states have no such personnel physically located within their borders. The Appeals process is the last step for taxpayers to argue the merits of their return before a Notice of Deficiency is recorded and collection processes begin. Therefore, it is critical that all taxpayers—even rural taxpayers—have unfettered access to IRS appeals officers. ... I think it is perfectly reasonable to suggest that the IRS redeploy existing resources to provide at least one full-time appeals officer and one full-time settlement agent in every state.<sup>21</sup>

In response, Treasury Secretary Geithner stated:

The appeals process uses circuit riding to mitigate the need for specialization and where the nearest office is more than 150 miles from the taxpayer, while at the same time ensuring that the needs of each and every taxpayer are timely met. This structure is consistent with the statutory requirement in the IRS Restructuring and Reform Act of 1998, which provides the IRS Commissioner must ‘ensure that an Appeals Officer is regularly available in each state.’

15 National Taxpayer Advocate 2009 Annual Report to Congress 81; IRM 8.6.1.4.1.1 (June 8, 2010).

16 National Taxpayer Advocate 2009 Annual Report to Congress 81.

17 See *id.*

18 IRM 8622 (April 20, 1990).

19 S. REP. NO. 105-174, at 88 (1998).

20 See 156 Cong. Rec. S2654 (2010).

21 Filing Season Update: Current IRS Issues, *Hearing before the S. Comm. on Finance*, 111th Cong., 18-19 (2010) (remarks of Sen. Enzi). See also Press Release, Senator Enzi, Budget Is Sweet and Sour: Enzi Improves Bill But Can’t Support Final (Apr. 22, 2010), available at [http://www.enzi.senate.gov/public/index.cfm/news-releases?ContentRecord\\_id=278e14e5-802a-23ad-4646-e63f9f3b85d6](http://www.enzi.senate.gov/public/index.cfm/news-releases?ContentRecord_id=278e14e5-802a-23ad-4646-e63f9f3b85d6) (last visited on Oct. 20, 2014).

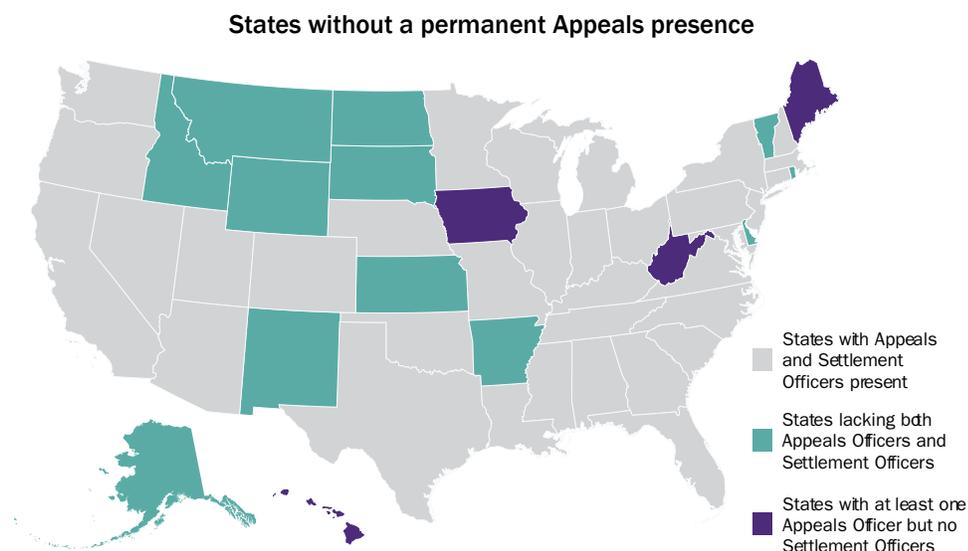
IRS, as part of its regular planning, will continue to look at resource allocation, and is committed to ensuring adequate access to the appeals process for every taxpayer.<sup>22</sup>

Ultimately, the Budget Resolution that included Senator Enzi's amendment was never acted upon by Congress. Nevertheless, the concerns giving rise to this legislation remain.

### In Practice, Many Taxpayers are Experiencing Limitations on Their Ability to Have an In-Person Appeals Conference With the IRS.

The number of states and territories in which Appeals lacks both an Appeals Officer and a Settlement Officer has grown by 33 percent since 2011. Twelve states and Puerto Rico, roughly a quarter of U.S. states and territories, have no Appeals or Settlement Officers with a post of duty within their borders.<sup>23</sup> The current distribution of states lacking a permanent Appeals presence is illustrated by the following map:

FIGURE 1.4.1<sup>24</sup>



Not only are states without an Appeals post of duty increasing, but the number of Appeals Officers and Settlement Officers located in existing field offices has diminished. Between the summer of 2010 and the summer of 2014, this category of Appeals personnel has dropped by approximately 27 percent, from 817 to 593.<sup>25</sup> Appeals Officers and Settlement Officers located in field offices are, among other things,

22 *The U.S.–China Economic Relationship: A New Approach For a New China*, Hearing Before the S. Comm. on Finance, 111th Cong., 69-70 (2010) (testimony of Timothy F. Geithner, Sec. of Treasury).

23 IRS, Human Resources Reporting Center, available at <https://persinfo.web.irs.gov/> (last visited June 27, 2014). This map does not include Puerto Rico, which also has no Appeals presence.

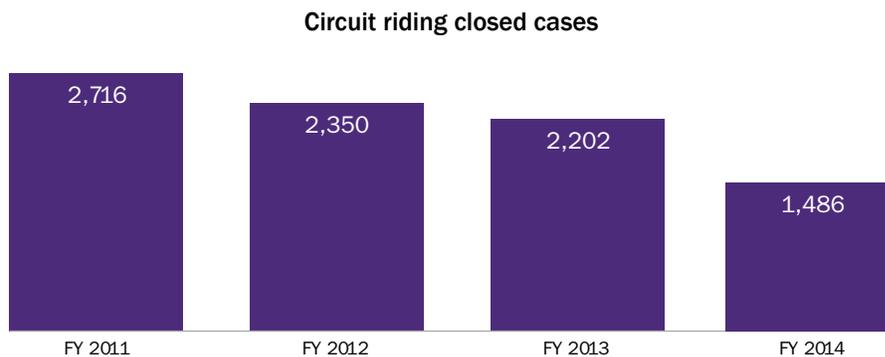
24 The following states lack both Appeals Officers and Settlement Officers: Alaska, Arkansas, Delaware, Idaho, Kansas, Montana, North Dakota, New Mexico, Rhode Island, South Dakota, Vermont and Wyoming. The following states have at least one Appeals Officer but no Settlement Officers: Hawaii, Iowa, Maine, and West Virginia. See Appeals' Response to TAS information request (Aug. 5, 2014).

25 See user data from on rolls listing, comparing personnel data from Aug. 23, 2010 with personnel data from Aug. 23, 2014, available at <https://persinfo.web.irs.gov/track/workorg.asp> (last visited on Oct. 2, 2014).

the group responsible for circuit riding. Accordingly, this reduction in field-based Appeals Officers and Settlement Officers has the impact of limiting the number of Appeals personnel available to ride circuit in states without an Appeals presence, and in rural areas where taxpayers lack access to an Appeals field office.

The overall number of Appeals cases closed via circuit riding likewise has progressively fallen in each of the last four years.<sup>26</sup> This trend is illustrated in the accompanying graph.

**FIGURE 1.4.27**



Although the IRS does not report this data on a state-by-state basis, it is not unreasonable to infer that there has been an equal or greater drop in the number of in-person Appeals conferences held in states with no Appeals presence. If the IRS wishes to make the case that circuit riding is sufficient to satisfy RRA 98 in states lacking a regular Appeals presence, the IRS should support this contention with data regarding the availability and effectiveness of face-to-face appeals in such states. Otherwise, the IRS's position regarding RRA 98 compliance is based on unsubstantiated assertions.

The National Taxpayer Advocate is concerned that this decreasing trend in the number of circuit riding cases, and the isolation it portends for states without an Appeals presence, is not the result of taxpayer choice. Rather, it is effectively imposed on taxpayers by the expansion of states without a permanent Appeals office and by the diminishing availability of Appeals personnel who can ride circuit.

### **The Lack of Face-to-Face Access to Appeals in all States is Harmful to Impacted Taxpayers.**

The ability to interact on a face-to-face basis with the IRS has a significant effect on taxpayer perceptions and satisfaction. For example, an IRS survey has indicated that overall satisfaction with face-to-face examinations is much higher (71 percent) than for correspondence examinations (43 percent).<sup>28</sup> Similarly,

26 Appeals does not report circuit riding data on a state-by-state basis. Appeals response to TAS information request (Aug. 5, 2014). Note that circuit riding can occur in rural areas of states that have permanent Appeals offices. Moreover, taxpayers in some states lacking a permanent Appeals presence occasionally have convenient access to a field office in a nearby state. Additionally, circuit riding can occur for reasons unrelated to geography, such as substantial books and records, high inventories, or lack of technical expertise. See IRM 8.6.1.4.1.1 (June 8, 2010). Nevertheless, this is currently the best available data regarding the effectiveness of circuit riding.

27 Appeals response to TAS information request (Aug. 5, 2014); supplemented by FY 2014 data provided by Appeals on November 6, 2014.

28 IRS, National Research Program 2011 Customer Satisfaction Survey (Feb. 9, 2012).

overall dissatisfaction is more than twice as great for correspondence examinations (41 percent) than for face-to-face examinations (18 percent).<sup>29</sup> Consistent with this data, TAS has also found that taxpayers receiving the Earned Income Tax Credit (EITC) are substantially more likely to respond to face-to-face examinations.<sup>30</sup> Likewise, a recent TAS study of taxpayers eligible to use low income taxpayer clinics (LITC) indicated that 77 percent of the surveyed taxpayers preferred face-to-face interactions with their local LITC.<sup>31</sup>

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The National Taxpayer Advocate is concerned that this decreasing trend in the number of circuit riding cases, and the isolation it portends for states without an Appeals presence, is not the result of taxpayer choice. Rather, it is effectively imposed on taxpayers by the expansion of states without a permanent Appeals office and by the diminishing availability of Appeals personnel who can ride circuit.

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The Appeals Customer Satisfaction Survey provides further evidence of the importance taxpayers place on the availability of face-to-face meetings. For example, in its 2008 survey, Appeals highlighted seven particular categories of specific suggestions from customer comments, one of which was, “Taxpayers would like in-person meetings with Appeals.”<sup>32</sup> Among other things, one survey taxpayer stated, “It would be nice to meet with somebody in person, it might get done faster face-to-face.”<sup>33</sup> Another taxpayer responded, “I feel they need to have face-to face appeals.”<sup>34</sup>

In addition to taxpayer perceptions and satisfaction, the National Taxpayer Advocate is particularly concerned that the lack of an Appeals presence in certain states has a demonstrably negative effect on the cycle times and outcomes of tax disputes in those states. Taxpayers forced to rely on circuit riding in order to obtain a face-to-face Appeals conference must wait substantially longer for a resolution of their appeals case than do taxpayers fortunate enough to live near an Appeals office. A comparison of the time needed for resolving Appeals cases (cycle time) is depicted in the table below.

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29 IRS, National Research Program 2011 Customer Satisfaction Survey (Feb. 9, 2012).

30 National Taxpayer Advocate, Briefing for the Enforcement Committee, *Examination Strategy: The Impact of Increasing Automation*, slide 15 (Apr. 23, 2012).

31 TAS, Survey of Taxpayers who are Eligible to Use IRS’s Low Income Taxpayer Clinics, slide 11, July 2014. Taxpayers are generally eligible to use LITCs if their income is at or below 250 percent of the federal poverty level (e.g., \$29,175 for a single taxpayer; \$59,625 for a family of 4 in calendar year (CY) 2014). See IRC § 7526(b)(1) for the definition of a qualified low income taxpayer clinic. For the 2014 Federal Poverty Guidelines, see U.S. Department of Health & Human Services, 2014 Poverty Guidelines, available at <http://aspe.hhs.gov/poverty/14poverty.cfm> (last visited on Oct. 20, 2014).

32 IRS, Appeals Customer Satisfaction Survey, National Report, Fiscal Year 2008 Results, slide 11, Feb. 2009, available at <http://appeals.web.irs.gov/stratplan/custsat.htm>.

33 *Id.*

34 *Id.*

**FIGURE 1.4.3, Cycle times (in days)<sup>35</sup>**

Fiscal year	Field cases with face-to-face conferences	Circuit riding
2011	388	628
2012	373	677
2013	344	816
2014	406	628

Moreover, circuit riding Appeals conferences have significantly higher indicia of disagreement between taxpayers and the IRS, and lower indicia of agreement, than face-to-face Appeals conferences conducted in field offices. This outcome is illustrated in the following table:

**FIGURE 1.4.4, Agreement/disagreement percentages comparison<sup>36</sup>**

Appeals percentages	Case types	FY 2011	FY 2012	FY 2013	FY 2014
Agreed	Field cases with face-to-face conferences	65%	64%	63%	63%
	Cases with circuit riding	51%	47%	52%	40%
Unagreed	Field cases with face-to-face conferences	14%	14%	15%	14%
	Cases with circuit riding	27%	30%	27%	33%

To the extent that taxpayer satisfaction, cycle time, and outcome are adversely affected, one factor may be that decisions are being made by Appeals Officers with no first-hand connection with, or knowledge of, the local area involved.<sup>37</sup> Appeals Officers who reside within the community, or at least in the same states as the taxpayers with whom they are interacting, have a greater likelihood of being well-versed in the local industries and economic circumstances prevailing in a particular region, and preserving both the appearance and the reality of fair and equitable consideration.<sup>38</sup> Conversely, taxpayers residing in a state without a permanent Appeals office may be disadvantaged in the presentation of their case, or disenchanted with the Appeals process itself, because of the cost and inconvenience of traveling extended distances for a hearing, or the wait for a circuit riding Appeals Officer to appear in an accessible location.

Reduced taxpayer satisfaction and negative outcomes, whether a result of perception or reality, can have a powerfully adverse downstream impact on the IRS as well. The potential consequences of limiting access to face-to-face Appeals conferences include an impaired IRS ability to determine litigation hazards,

35 Appeals response to TAS information request (Aug. 5, 2014); supplemented by FY 2014 data provided by Appeals on November 6, 2014. Note that the column entitled “Field cases with face-to-face conferences” excludes cases held via circuit riding, which are separately stated for comparison. References to “field” information in subsequent tables likewise excludes circuit riding data.

36 Data for this figure is drawn from Attachments 3 and 4 of Appeals’ response to TAS information request (Aug. 5, 2014) as supplemented by FY 2014 data provided by Appeals on November 6, 2014. Agreed cases combine codes 03 (Agreed Non-Docketed), 08 (Docketed – Appeals Secured Agreement), and 15 (Fully Allowed) set forth in those attachments. Unagreed cases combine codes 05 (Defaulted Notice of Deficiency), 13 (Unagreed Non-Docketed), and 14 (Fully Disallowed), also provided in those attachments. Other codes are excluded from this agreed/unagreed analysis as, for example, they reflect cases resolved after leaving Appeals’ jurisdiction or cases that are only partially agreed and partially unagreed. Even if such codes were considered as part of the analysis, however, the trends illustrated in the accompanying table would remain present.

37 National Taxpayer Advocate 2009 Annual Report to Congress 76; National Taxpayer Advocate 2009 Annual Report to Congress 347-48.

38 *Id.* See also Filing Season Update: *Current IRS Issues, Hearing before the S. Comm. on Finance, 111th Cong., 18-19 (2010)* (remarks of Sen. Enzi).

evaluate collection alternatives, and timely settle cases. As a result, cases that Appeals could have resolved may be left for IRS counsel attorneys to settle or litigate, resulting in downstream costs for the government. Likewise, some taxpayers may feel they are compelled to bring suit in court in order to gain the opportunity to present their case in person. Thus, the lack of a permanent Appeals office in each state may well have the unintended consequence of draining IRS administrative resources and increasing litigation with taxpayers.

### **Videoconferencing Could Be Part of the Solution with Respect to the Lack of Appeals Presence, but Is Not a Cure-All.**

Recognizing that videoconferencing might be one means of alleviating the scarcity of Appeals Officers in a given state or area, Congress, as part of RRA 98, also directed the IRS to consider using videoconferencing as a means of holding Appeals conferences “between appeals officers and taxpayers seeking appeals in rural or remote areas.”<sup>39</sup> Although the IRS has moved slowly in responding to this directive, recently some IRS divisions, including Appeals, have held pilot studies of virtual service delivery (VSD).<sup>40</sup> These pilots, as well as the experiences of other agencies such as the Social Security Administration and the Department of Veterans Affairs, indicate that VSD holds great promise for expanding the accessibility, timeliness, and quality of IRS service delivery through virtual face-to-face technology.<sup>41</sup>

The IRS should continue to expand the scope and availability of VSD. Nevertheless, VSD, or any other means of conducting an Appeals conference, should never supersede, or in any way compromise, a taxpayer’s right to an in-person Appeals conference with an Appeals Officer stationed in the taxpayer’s state of residence.

## **CONCLUSION**

When passing RRA 98, Congress expressed the desire that “all taxpayers should enjoy convenient access to Appeals, regardless of their locality.” Nevertheless, the number of states without a permanent Appeals office has been steadily rising. The IRS’s contention that this absence can be remedied by riding circuit, however, is not supported by the available evidence. Rather, the number of face-to-face Appeals conferences held through circuit riding is steadily falling. Taxpayer satisfaction, the appearance of fairness, and the outcome of proceedings are all adversely affected by the lack of an Appeals Officer and a Settlement Officer in each state. Congress desired better for taxpayers, and more from the IRS, when it passed § 3465(b) of RRA 98.

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39 RRA 98, Pub. L. No. 105-206, Title III, Subtitle E, § 3465(c) (July 22, 1998).

40 Additionally, Appeals recently has established procedures for making VSD available for Campus Appeals in situations where Appeals personnel are co-located with VSD equipment and the taxpayer or representative is located within 100 miles of a VSD customer-facing location. See Memorandum from John Cardone, Director, Policy Quality and Case Support to Appeals Employees, Re: Implementation of Virtual Service Delivery (VSD), (July 24, 2014). To this point, however, the lack of customer-facing locations places a significant practical limitation on the ability of taxpayers to utilize this option.

41 VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services, *infra*.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS should:

1. Expand Appeals duty locations in a way that ensures at least one Appeals Officer and one Settlement Officer are stationed within every state, the District of Columbia, and Puerto Rico.
2. Begin systematically collecting information allowing for a more precise analysis of the timeliness and fairness of Appeals conferences conducted through circuit riding both in states without a permanent Appeals presence and in states where Appeals field offices are augmented by circuit riding.

**MSP  
#5****VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations****RESPONSIBLE OFFICIAL**

Debra Holland, Commissioner, Wage and Investment Division

**DEFINITION OF PROBLEM**

On January 2, 2014, the IRS ceased providing free return preparation services at its local Taxpayer Assistance Centers (TACs).<sup>1</sup> Instead, taxpayers were directed to use Free File, tax preparation software that is free for taxpayers whose 2013 incomes were less than \$58,000, or obtain the services at Volunteer Income Tax Assistance and Tax Counseling for the Elderly (VITA or TCE) sites.<sup>2</sup>

In fiscal year (FY) 2014, VITA and TCE programs prepared 3,472,696 returns, an increase of about 27 percent over the FY 2009 level.<sup>3</sup> VITA and TCE sites that received funding from the IRS, also referred to as award grantees, alone prepared more than 1.4 million and 1.3 million returns, respectively, during FY 2014.<sup>4</sup> Inexplicably, the IRS awarded VITA grantees \$100,000 less than in FY 2013 and committed more resources to the TCE grant program, despite the fact that the number of returns prepared by VITA programs increased at a substantially higher rate than the number of returns prepared by TCE programs in FYs 2009-2013.<sup>5</sup> Because every VITA grant dollar must be matched by the VITA grantee, a requirement not imposed on TCE grantees, the IRS funding decision had the effect of reducing resources available to the VITA grant program by two hundred thousand dollars in FY 2014.

These data do not capture the number of taxpayers who are turned away from VITA or TCE sites because the issues they need help with are “out of scope.”<sup>6</sup> VITA and TCE sites have reported an increase in these

- 1 TACs are local IRS sites where taxpayers can go for face-to-face assistance. IRS, *Contact Your Local IRS Office*, available at <http://www.irs.gov/uac/Contact-Your-Local-IRS-Office-1> (last visited Oct. 27, 2014).
- 2 VITA and TCE sites provide free tax preparation services for qualified individuals in conjunction with IRS assistance and direction. See IRS, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources*, available at <http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources> (last visited Oct. 17, 2014); IRS, *Free File: Do Your Federal Taxes for Free*, available at <http://www.irs.gov/uac/Free-File:-Do-Your-Federal-Taxes-for-Free> (last visited Oct. 27, 2014). The income amount changes each taxable year.
- 3 IRS response to TAS information request (Aug. 15, 2014). In FY 2009, VITA prepared 417,741 returns; TCE sites prepared 1,538,181 returns; and VITA Grantees—a total of 779,734 returns (included in the total VITA number).
- 4 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014). The number of returns prepared by VITA grantees increased by 66,182 in FY 2014 compared to FY 2013. The number of returns prepared by TCE grantees decreased in FY 2014 for the first time, by 251,929 returns compared to FY 2013.
- 5 TAS teleconference with Wage and Investment (W&I) (Nov. 24, 2014). W&I was unable to explain why or how funding over the congressionally appropriated amounts (discretionary funding) were determined. IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014). TCE grantees prepared 1,538,181 returns in FY 2009 and 1,595,860 returns in FY 2013, resulting in an increase of 57,679 returns. VITA grantees prepared 779,734 returns in FY 2009 and 1,353,433 in FY 2013, an increase of 573,699 returns. See Figure 1.5.2, *Tax Returns Prepared at VITA/TCE Sites in FYs 2009-2014* *infra*.
- 6 “Out of scope” returns include forms, schedules, and tax law topics the IRS identifies each year, which may change every year. Examples of out of scope items are cancellation of debt other than nonbusiness credit card debt, some expenses on Form 3903, *Moving Expenses*, some Forms 1040X, *Amended Returns*, and transactions in virtual currencies. See IRS Pub. 4012, *VITA/TCE Volunteer Resource Guide, Scope of Service* 8-10 (Oct. 2014).

types of returns.<sup>7</sup> IRS Free File software cannot address these issues either.<sup>8</sup> Consequently, these taxpayers have nowhere to turn for free assistance in preparing their returns.<sup>9</sup>

The National Taxpayer Advocate is concerned that the IRS's approach to free tax preparation assistance falls short of Congress' expectations that the IRS would "extend services to underserved populations and hardest-to-reach areas, ... heighten quality control, enhance training of volunteers, and significantly improve the accuracy rate of returns prepared by VITA sites."<sup>10</sup>

By eliminating tax preparation services at TACs and inadequately supporting VITA or TCE sites, the IRS makes it more difficult for taxpayers to obtain tax preparation assistance that helps them meet their reporting obligations and comply with the tax laws. These shortcomings burden taxpayers because those who cannot obtain free filing assistance may pay more in taxes than they are legally required to pay, or seek preparation services from unqualified or unscrupulous preparers, undermining voluntary compliance and eroding the *taxpayer's rights to be informed, to quality service, and to pay no more than the correct amount of tax.*<sup>11</sup>

## ANALYSIS OF PROBLEM

### Background

Volunteer taxpayer assistance programs administered by the IRS originated with the Tax Reform Act of 1969 and were later consolidated as VITA.<sup>12</sup> VITA partners offer free tax assistance and help in preparing income tax returns for low to moderate income individuals, the disabled, the elderly, and those with limited English proficiency (LEP).<sup>13</sup> The IRS provides VITA partners with tax preparation software, limited amounts of hardware, online training for volunteer certification, and advertising on IRS.gov. VITA partners are responsible for all other aspects of their program, including:

- Publicity;
- Volunteer recruitment;
- Training;
- Providing the site; and

7 2014 Common Cents Conference, IRS VITA Communications Panel, *Impact of Taxpayer Assisted Center Closures: VITA Field Survey Results*, available at <http://commoncentsconference.mdcash.org/wp-content/uploads/2013/01/VITA-Field-Survey-Summary-FINAL.pdf> (last visited Dec. 16, 2014).

8 IRS, *Available Forms and Limitations*, available at <http://www.irs.gov/uac/List-of-Available-Free-File-Fillable-Forms> (last visited Dec. 16, 2014).

9 TACs were able to prepare tax returns that are more technical and did not have as many out of scope limitations compared to the VITA or TCE sites and the Free File software.

10 S. Comm. on Appropriations, *Financial Services and General Government Appropriations Bill, 2014*, report to accompany S. 1371, 113th Cong., S. REP. No. 113-80, at 27 (2014).

11 On June 10, 2014, the IRS formally adopted the Taxpayer Bill of Rights (TBOR). See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). The *right to be informed* includes the right to know what the taxpayer need to do to comply with the tax laws and clear explanations of the laws and IRS procedures. The *right to quality service* includes the right to receive prompt, courteous, and professional assistance in their dealings with the IRS. Taxpayers also have the *right to pay only the amount of tax legally due*, including interest and penalties.

12 See *Income Tax Overpayments by the Elderly*, IRS Commissioner Hearing Before the S. Comm. On Aging, 95th Cong. 44 (1970) (statement of Randolph W. Throver, IRS Commissioner). Commissioner Throver submitted a written answer to Congress describing the Taxpayer Assistance Training Program, which was the pilot of the IRS volunteer tax programs. See also IRS Pub. 4671, *VITA Grant Program Overview and Application Instructions* 6 (Apr. 2014).

13 IRS, *Free Tax Return Preparation for Qualifying Taxpayers*, available at <http://www.irs.gov/Individuals/Free-Tax-Return-Preparation-for-You-by-Volunteers> (last visited on Nov. 14, 2014).

- All aspects of management.<sup>14</sup>

The IRS administers the VITA program through the Stakeholder Partnership, Education and Communications program (SPEC) in the W&I division.<sup>15</sup>

Prior to 2007, the VITA partners funded their programs without any financial assistance from the IRS. However, in December 2007 Congress created and appropriated funding for the VITA grant program to provide matching funds (*i.e.*, the IRS may match the funds the organization has secured).<sup>16</sup> In 2008, the House Appropriations Committee directed the IRS, through VITA and TCE, to “strengthen, improve, and expand taxpayer service overall.”<sup>17</sup> The Committee explained the purpose of the VITA grant funds was “[t]o enable VITA programs to extend services to underserved populations and hardest-to-reach areas, both urban and non-urban, as well as to increase the capacity to file returns electronically, heighten quality control, enhance training of volunteers, and significantly improve the accuracy rate of returns prepared by VITA sites.”<sup>18</sup>

Once awarded, grant funds are restricted and can only be used for reasonable costs that would not have existed but for the program, such as:

- Hardware used to prepare returns;
- Salaries, wages, and benefits of clerical personnel, interpreters, program and site coordinators, and tax law instructors;
- Office supplies;
- Rent;
- Utilities; and
- Equipment and technical personnel that relate to electronic filing services.

The IRS does not allow VITA or TCE to use grant funds as compensation for tax assistants or preparers, screeners, or quality reviewers.<sup>19</sup> Not all VITA participants seek or receive grants; some operate without monetary support from the IRS.

In 1978, Congress created the TCE program, which allows the IRS to provide funding (without the matching requirement) to various private and public nonprofit agencies and organizations that offer free

14 Internal Revenue Manual (IRM) 22.30.1.5.1.2(6), *Volunteer Income Tax Assistance (VITA) Grant* (Oct. 01, 2011).

15 SPEC handles the outreach and education functions of the IRS, and manages the VITA and TCE programs. SPEC’s mission is to “assist taxpayers in satisfying their tax responsibilities” and is accomplished by partnering with various organizations providing access to low income and underserved populations in the local communities. IRM 22.30.1.1(2), *What is Stakeholder Partnerships, Education and Communications* (Oct. 1, 2013).

16 Consolidated Appropriations Act of 2008, Pub. L. No. 110-161, 121 Stat. 1844, 1975-76 (2007). See also IRM 22.30.1.5.1.2(2), *Volunteer Income Tax Assistance (VITA) Grant* (Oct. 01, 2011). The IRS may match funds that an organization provides in the form of cash, software, hardware, supplies, salaries, and volunteer services. IRS, *VITA Grant FAQs Category: Matching Funds* (Mar. 28, 2014), available at <http://www.irs.gov/Individuals/VITA-Grant-FAQs-Category:Matching-Funds>. The goal of the grant program is to provide free tax return preparation and electronic filing to taxpayers that are low to moderate-income, elderly, disabled, and individuals with limited English proficiency. IRM 22.30.1.5.1.2(3), *Volunteer Income Tax Assistance (VITA) Grant* (Oct. 01, 2011).

17 H. Comm. on Appropriations, *Financial Services and General Government Appropriations Bill, 2008*, report to accompany H.R. 2829, 110th Cong., H.R. REP. No. 110-207, at 26 (2008).

18 153 CONG. REC. H16049 (daily ed. Dec. 17, 2007).

19 IRM 22.30.1.3.3.1.2(1), *Compensation for the Grant Program* (Oct. 01, 2011).

tax counseling and assistance to individuals over the age of 60.<sup>20</sup> TCE volunteers are IRS-certified and serve all taxpayers but specialize in issues unique to older taxpayers, such as pensions and retirement.<sup>21</sup>

### **Congress Intended the IRS to Sufficiently Fund, Expand, and Improve the Reach of the VITA and TCE Programs.**

At the same time Congress authorized funding for the VITA grant program, legislators were concerned about the IRS reducing taxpayer services and the associated adverse impact on voluntary compliance:

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**The IRS discontinued tax preparation services at Taxpayer Assistance Centers without properly evaluating the limitations of the most vulnerable taxpayer populations—the elderly, low income, rural, and those not proficient in English.**

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If the IRS proposes further reductions in specific taxpayer services ... the IRS must demonstrate that such reductions will not result in a decline in voluntary compliance. Where such reductions involve a reduction in face-to-face service, the IRS must demonstrate that the proposed reductions do not adversely impact compliance by taxpayers ...<sup>22</sup>

In 2014, Congress directed the IRS to “expand the quantity and funding level of VITA grants focused on serving persons with disabilities proportional to the growing disability population requiring tax assistance” and “allow national coalitions responsible for the coordination of local community partnerships focused specifically on the expanded provision of tax services for individuals with disabilities to compete in the VITA community matching grant processes.”<sup>23</sup> Congress directed the IRS to fund the TCE and VITA programs at no less than \$5,600,000 and \$12,000,000 respectively.<sup>24</sup>

### **Eliminating Tax Return Preparation Services at TACs Harms the Most Vulnerable Taxpayers and Voluntary Compliance.**

Prior to 2014, taxpayers turned to TACs for assistance in preparing and filing tax forms such as IRS Form 1040 Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, complicated and advanced forms such as Schedule D, *Capital Gains and Losses*, and Schedule F, *Profit or Loss From Farming*, because VITA and TCE sites generally cannot prepare these out-of-scope forms.<sup>25</sup> In addition to Schedules C, D, and F, low and moderate income taxpayers also may need tax preparation assistance with Form 3903, *Moving Expenses* and Form 1099-C, *Cancellation of Debt*.<sup>26</sup> At the start of 2014, the IRS stopped preparing returns at TACs and directed taxpayers to use other free options such as the IRS Free File program,

20 Federal Grant and Cooperative Agreement Act of 1977, Pub. L. No. 95-224, § 6, 92 Stat 3, 5 (1978). See also Statement of Procedural Rules, Treas. Reg. § 601.802. Unlike VITA grant funding, TCE grant funding does not require matching funds.

21 IRS, *Free Tax Return Preparation for Qualifying Taxpayers*, available at <http://www.irs.gov/Individuals/Free-Tax-Return-Preparation-for-You-by-Volunteers> (last visited on Nov. 14, 2014).

22 153 CONG. REC. H16049 (daily ed. Dec. 17, 2007).

23 U.S. Congress, S. Comm. on Appropriations, *Financial Services and General Government Appropriations Bill, 2014*, report to accompany S. 1371, 113th Cong., S. REP. No. 113-80, at 28 (2014).

24 Consolidated Appropriations Act of 2014, Pub. L. No. 113-76, 128 Stat. 5, 188 (2014).

25 IRS Pub. 3676 (EN/SP), *IRS Certified Volunteers Providing Free Tax Preparation 1* (Jan. 2014). In June 2013, the National Taxpayer Advocate met with executives from the IRS Wage & Investment division to discuss the National Community Tax Coalition (NCTC), a SPEC national partner, request for the IRS to reconsider a decision to discontinue the Expanded Form 1040 Schedule C, *Profit or Loss From Business (Sole Proprietorship)* pilot tax return preparation program after the 2013 filing season. The discussions resulted in SPEC continuing the program.

26 Pub. 4012, *VITA/TCE Volunteer Resource Guide, Scope of Service 8-10* (Oct. 2014).

Facilitated Self-Service Assistance (FSA) sites, or VITA and TCE.<sup>27</sup> The IRS stated that commercial tax software and paid preparers are additional options.<sup>28</sup> However, these alternatives are not replacements for the service formerly offered by TACs. Unlike TACs, VITA and TCE sites and Free File software cannot prepare forms or handle issues that are “out of scope.” Low income taxpayers may not be able to afford software or a paid preparer, while taxpayers with disabilities, limited technology skills, or no access to a computer may be unable to use Free File or commercial software.

As discussed in the National Taxpayer Advocate’s 2013 Annual Report to Congress, TACs are preferred by some taxpayers “who do not have Internet access or prefer in-person assistance.”<sup>29</sup> A 2011 SPEC Rural Strategy Initiative acknowledged, “[e]ven though the percentage of low-income residents per capita is higher in rural areas than in larger cities, the coverage rates for free tax preparation services are lower. While many partners want to service rural areas, there are often barriers and challenges that are difficult to overcome.”<sup>30</sup> As the Senate Appropriations Committee FY 2015 Financial Services and General Government Subcommittee draft report noted, “Given the significant wait times and deteriorating rate of response for assistance provided through the national toll-free line, it is imperative the IRS Taxpayer Assistance Centers [TACs] in rural areas are fully staffed and capable of resolving taxpayer issues.”<sup>31</sup>

The IRS discontinued tax preparation services at TACs without properly evaluating the limitations of the most vulnerable taxpayer populations—the elderly, low income, rural, and those not proficient in English. In April 2012, members of the Taxpayer Advocacy Panel (TAP) performed a survey of taxpayers that indicates that even though taxpayers tried to resolve their issues through other means, they still needed face-to-face assistance from a TAC.<sup>32</sup> The IRS’s own taxpayer service plan acknowledges that some taxpayers, including those with income restrictions, the elderly, or individuals with limited English abilities, are more likely to visit a location that offers face-to-face services to complete their tasks.<sup>33</sup> Individuals prefer face-to-face help for a few reasons:

- Some may want the opportunity to receive an immediate response, or to clarify that they fully understand any information, direction, or guidance;
- Some may lack computer or Internet access;<sup>34</sup> and

27 IRS, *Growth Through Alternative Filing Strategies in the Next ERA* FY 2014 Program Guide 7 (2014). See also IRS, *Contact Your Local IRS Office*, available at <http://www.irs.gov/uac/Contact-Your-Local-IRS-Office-1> (last visited on Oct. 17, 2014). FSA is interactive tax preparation software that is available at some VITA and TCE sites that the taxpayer uses with very little assistance and does not require face-to-face interaction. For further information on Face-to-Face taxpayer services, see National Taxpayer Advocate 2012 Annual Report to Congress 20-39 (Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*).

28 IRS, *FY 2014 Service Approach Return Preparation Clarification* 3 (Jun. 9, 2014).

29 See National Taxpayer Advocate 2013 Annual Report to Congress 20-39, at 30 (Most Serious Problem: *IRS BUDGET: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance*).

30 IRS, *Fact Sheet for SPEC Partners, SPEC Rural Strategy Initiative* 1 (July 2011). Since FY 2012, W&I rural areas as part of the overall low income population and no longer captures or has knowledge of the actual coverage rates for rural areas. IRS response to fact check (Dec. 27, 2014).

31 *FY15 Financial Services and General Government Subcommittee Reported Bill and Draft Report* (July 24, 2014), available at <http://www.appropriations.senate.gov/news/fy15-fsgg-subcommittee-reported-bill-and-draft-report> (last visited Oct. 30, 2014).

32 The TAP is a federal advisory committee comprised of citizen volunteers who work to improve IRS services by providing the taxpayers’ perspective to various IRS operations. The National Taxpayer Advocate and her Research and Systemic Advocacy staffs provided support to this survey effort. TAP volunteers returned 664 completed surveys from 37 different TAC offices. While these results are not statistically representative of all TAC visitors, they represent the needs and activities of a sizable number of TAC customers during one week in the tax filing season. Percentages shown are out of all 664 respondents. Some respondents did not answer every question. Taxpayer Advocacy Panel, 2012 Annual Report 33 (Apr. 2012).

33 IRS, 2007 Taxpayer Assistance Blueprint Phase II, 111.

34 Kathryn Zickuhr, Pew Research Center, *Who’s not online and why* 2 (Sep. 25, 2013), available at <http://www.pewinternet.org/2013/09/25/main-report-2/>.

- Some may have education, income, disability, language, or age barriers.<sup>35</sup>

According to a Pew study, “[a]s of May 2013, 15 percent of American adults age 18 and older do not use the internet or email.”<sup>36</sup> The study found, “[a]s in previous surveys, internet use remains strongly correlated with age, education, and household income.”<sup>37</sup> Pew also noted, “Many seniors have physical conditions or health issues that make it difficult to use new technologies.”<sup>38</sup> The following percentages of adults are not online:

- 44 percent of those over the age of 65;
- 41 percent of those who have not graduated from high school;
- 24 percent of Hispanics;
- 15 percent of black non-Hispanics;
- 24 percent of those residing in households with income of less than \$30,000 per year; and
- 20 percent of those living in rural areas.<sup>39</sup>

All of these taxpayers are more likely to need face-to-face services.<sup>40</sup> However, in the absence of return preparation services at TACs, their tax assistance options are limited to paid preparers, commercial software, or VITA or TCE sites. Some taxpayers turn to Low Income Taxpayer Clinics (LITCs), but the clinics’ mission is to provide low income taxpayers representation in tax controversies, and they generally cannot prepare current-year tax returns.<sup>41</sup> As a result, some taxpayers may become frustrated and stop filing returns altogether.

### Increased Activity and Inadequate Resources at VITA/TCE Sites Burden Taxpayers Who Depend on Them.

In FY 2014, the IRS funded both VITA and TCE at the congressionally appropriated levels, but decreased discretionary funding for the VITA program and increased discretionary funding for the TCE program for FY 2014 as compared to FY 2013 levels.<sup>42</sup> As depicted below, VITA discretionary funding decreased by one percent, from \$12.1 to \$12 million and TCE discretionary funding rose by nine percent, from \$5.6 million to \$6.1 million.

35 Kathryn Zickuhr, Pew Research Center, *Who’s not online and why 2*, 4 (Sep. 25, 2013), available at <http://www.pewinternet.org/2013/09/25/main-report-2/>. Pew found that groups of individuals with similar characteristics to older and less affluent persons over the age of 65 had “significant challenges with health or disability” that prevented their use of “digital tools and services, both physically and psychologically.” Aaron Smith, Pew Research Center, *Older Adults and Technology Use 1* (Apr. 3, 2014), available at <http://www.pewinternet.org/2014/04/03/older-adults-and-technology-use/>.

36 *Id.* at 4.

37 *Id.*

38 Aaron Smith, Pew Research Center, *Older Adults and Technology Use 2* (Apr. 3, 2014), available at <http://www.pewinternet.org/2014/04/03/older-adults-and-technology-use/>.

39 Kathryn Zickuhr, Pew Research Center, *Who’s not online and why 2* (Sep. 25, 2013), available at <http://www.pewinternet.org/2013/09/25/main-report-2/>.

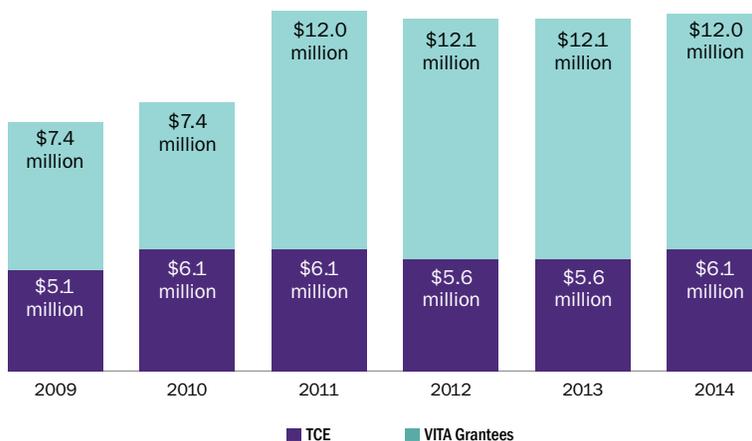
40 IRS, 2007 Taxpayer Assistance Blueprint Phase II, 111.

41 Internal Revenue Service Restructuring Act of 1998, Pub.L. No. 105-206, Title III, § 3601(a), 112 Stat. 685, 774 (1998). See also IRC § 7526. The LITC program was created and funded to provide taxpayers much needed tax assistance when there is a tax controversy with the IRS. Any other purpose is an inappropriate use of LITC grant funds.

42 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014). For FY 2014 the IRS award amount for the VITA and TCE sites was \$12 million and \$6.1 million respectively.

FIGURE 1.5.1<sup>43</sup>

IRS funding of volunteer programs, FYs 2009-2014



During the same period, the number of tax returns prepared by VITA sites increased five percent while the number prepared by TCE decreased 16 percent as shown on Figure 1.5.2.<sup>44</sup>

FIGURE 1.5.2<sup>45</sup>

Tax returns prepared at VITA/TCE sites, FYs 2009-2014



43 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014).

44 *Id.* The IRS awarded seven fewer grants to VITA sites from FY 2013 to FY 2014 while the number remained the same for the TCE sites for the same period. The IRS increased funding for the TCE sites while the number of returns prepared by these sites decreased for the first time since the program was created.

45 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014).

The IRS awarded seven fewer grants to VITA sites from FY 2013 to FY 2014 while the number remained the same for the TCE sites for the same period.<sup>46</sup> The IRS increased discretionary funding for the TCE sites despite the fact that the number of returns prepared by TCE sites increased at a significantly slower pace than the number of returns prepared by VITA sites in FYs 2009-2013.<sup>47</sup> In fact, the number of returns prepared at TCE sites decreased in FY 2014 for the first time since the program was created.<sup>48</sup> The decision by the IRS to decrease discretionary funding for VITA also decreased the dollar amount of matching funds dedicated to volunteer tax preparation by two hundred thousand dollars.<sup>49</sup> Moreover, since VITA programs actually increased the number of returns prepared in FY 2014 despite funding cuts, the IRS could have served more taxpayers by increasing funding for VITA programs.<sup>50</sup> It is unclear on what basis the IRS decided to supplement the congressionally directed appropriations level for the TCE program by about \$500,000 while allowing funding for the VITA program to decline.

As the Treasury Inspector General for Tax Administration has noted, the combination of increased activity and decreased funding can strain the VITA and TCE program partners' ability to meet taxpayer needs and improve voluntary compliance.<sup>51</sup> The increased burden on the programs may force some sites to turn people away, while others may be unable to provide quality services.<sup>52</sup> This may leave taxpayers with no way to obtain prompt, courteous, and professional assistance from the IRS as well as organizations funded by the IRS, undermining the taxpayer right to quality service.<sup>53</sup>

A small sample of VITA site responses to a survey conducted by the non-profit Maryland CASH Campaign includes specific concerns about the IRS's decision to eliminate tax preparation services at TACs.<sup>54</sup> Those include:

- Increased referrals from TACs for returns involving issues that are out of scope for VITA sites;
- Increased referrals outside of tax season (most VITA sites are open only during the tax season);
- Increased referrals for amended and prior year returns;
- A simultaneous decrease in IRS SPEC staff traveling to the VITA sites;
- A simultaneous decrease in IRS SPEC staff conducting training or presentations; and

46 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014).

47 *Id.*

48 *Id.*

49 IRS response to TAS information request (Nov. 19, 2014).

50 IRS response to TAS information request (Aug. 15, 2014 and Nov. 19, 2014) and IRS response to fact check (Dec. 27, 2014). VITA grantees prepared 66,182 more returns in FY 2014 than in FY 2013 (1,419,615 vs. 1,353,433), while TCE grantees prepared 251,929 fewer returns over the same period (1,343,931 vs. 1,595,860).

51 Treasury Inspector General for Tax Administration (TIGTA), Audit No. 201240049, *Additional Steps Are Needed to Ensure the Volunteer Income Tax Assistance Grant Program Reaches More Underserved Taxpayers* (Apr. 30, 2012).

52 The guiding principle of the IRS VITA Grant Program is that the grantees should show "incremental increases" in their return preparation each year. The IRS also expects grantees to achieve 100 percent of their grant agreement goals as well as increasing the amount of returns compared to the prior year with similar amounts of funding. IRS, Pub. 4883, *Grant Programs Resource Guide for VITA Volunteer Income Tax Assistance & TCE Tax Counseling for the Elderly* 5 (Aug. 2014).

53 IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014).

54 Maryland CASH Campaign released the survey at the 2014 Common Cents Conference. 2014 Common Cents Conference, IRS VITA Communications Panel, *Impact of Taxpayer Assisted Center Closures: VITA Field Survey Summary Results*, available at [https://www.surveymonkey.com/sr.aspx?sm=mDtFjCp\\_2f5M9bobk33J0o8\\_2ffhVCxf2eyFcarkizSSx4\\_3d](https://www.surveymonkey.com/sr.aspx?sm=mDtFjCp_2f5M9bobk33J0o8_2ffhVCxf2eyFcarkizSSx4_3d) (last visited Nov. 15, 2014).

- A simultaneous decrease in the availability of IRS resources, such as training materials and site tools.<sup>55</sup>

VITA and TCE sites must perform intake and interview each taxpayer who visits a site;<sup>56</sup> however, the sites do not report the time spent on intake and processing for a taxpayer whose issue is out of scope or needs an amended or prior year tax returns prepared. The initial interviews provide valuable information and guidance to taxpayers, even if they ultimately cannot be assisted by the VITA or TCE site. However, by the IRS not counting and funding the time spent on this valuable service, taxpayers experience longer wait times or risk being turned away. These limitations, in the absence of tax return preparation services at TACs, erode the taxpayer's *right to be informed* of compliance requirements and receive a clear explanation of the laws and procedures.<sup>57</sup>

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**The IRS's restrictions on which volunteers can prepare prior year or amended returns, combined with the limitations of software, discourage sites from preparing these returns. And because the IRS no longer prepares them in the Taxpayer Assistance Centers, taxpayers no longer have access to free assistance in this area.**

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### VITA/TCE Programs Are Subject to Limitations and Restrictions that Impede Their Effectiveness.

In addition to the out of scope restrictions, the IRS suggests that volunteer preparers have two years of previous experience and be trained and certified at the advanced level before preparing prior year or amended returns. This policy means some taxpayers will not receive service, because the sites lack preparers qualified to handle their returns.<sup>58</sup> Volunteer preparers who work in the tax and accounting field, such as attorneys and certified public accountants, are also burdened by the IRS training and certification policy requirement that volunteers who answer tax law questions, instruct tax law classes, prepare or correct tax returns, or conduct quality reviews of completed tax returns must be certified in tax law annually.<sup>59</sup> The IRS should require these volunteers to recertify only on new provisions and changes in tax law much like the IRS proposed in its pre-*Loving* regulation of return preparers, which could possibly increase volunteer participation.<sup>60</sup>

Moreover, although the IRS encourages electronic filing, the TaxWise software it provides to VITA and TCE volunteers allows return preparation only for the current year and the three previous taxable years.<sup>61</sup> Because VITA and TCE sites are only authorized to use this software, they cannot fully assist a taxpayer

55 2014 Common Cents Conference, IRS VITA Communications Panel, *Impact of Taxpayer Assisted Center Closures: VITA Field Survey Summary Results*, available at [https://www.surveymonkey.com/sr.aspx?sm=mDtFjCp\\_2f5M9bobk33JOo8\\_2ffhVCxf2eyFcarkezSSx4\\_3d](https://www.surveymonkey.com/sr.aspx?sm=mDtFjCp_2f5M9bobk33JOo8_2ffhVCxf2eyFcarkezSSx4_3d) (last visited Nov. 15, 2014).

56 IRM 22.30.1.3.13.1.2, *Intake and Interview Process* (Oct. 1, 2014).

57 IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014).

58 IRS, *Fact Sheet for SPEC Partners, Preparing Prior Year and Amended Returns at VITA/TCE sites* (Oct. 2014), available at [http://www.irs.gov/pub/irs-utl/Fact\\_Sheet\\_Prior\\_Year\\_and\\_Amended>Returns%20with%20Addendum\\_Updated%2010-3-14.pdf](http://www.irs.gov/pub/irs-utl/Fact_Sheet_Prior_Year_and_Amended>Returns%20with%20Addendum_Updated%2010-3-14.pdf) (last visited Oct. 30, 2014).

59 IRM 22.30.1.3.13.1.2, *Intake and Interview Process* (Oct. 1, 2014). The IRS provides training to volunteers through the Link and Learn application. IRM 22.30.1.3.7.1.3, *Link and Learn Taxes (LLT)* (Oct. 1, 2014).

60 *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014) (upholding the District Court's decision to enjoin the IRS's enforcement of the testing and CE requirements).

61 The IRS is required by law to facilitate electronic filing (e-file) of returns. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206, § 2001, 112 Stat. 723 (1998). IRS, *Fact Sheet for SPEC Partners, Preparing Prior Year and Amended Returns at VITA/TCE sites* (Oct. 2014), available at [http://www.irs.gov/pub/irs-utl/Fact\\_Sheet\\_Prior\\_Year\\_and\\_Amended>Returns%20with%20Addendum\\_Updated%2010-3-14.pdf](http://www.irs.gov/pub/irs-utl/Fact_Sheet_Prior_Year_and_Amended>Returns%20with%20Addendum_Updated%2010-3-14.pdf) (last visited Oct. 30, 2014).

who has several years of returns to be filed.<sup>62</sup> The IRS's restrictions on which volunteers can prepare prior year or amended returns, combined with the limitations of software, discourage sites from preparing these returns. And because the IRS no longer prepares them in the TACs, taxpayers no longer have access to free assistance in this area.

Taxpayers *have a right to pay no more than the current amount of tax due*. However, restrictions on VITA sites with respect to the types of permitted return preparation may lead to taxpayers failing to file a timely return, which could result in the taxpayer owing more than the original amount, due to penalties and interest.<sup>63</sup>

In light of the restrictions and limitations discussed above, the IRS grant funding process must change to reduce the additional burdens on taxpayers and the VITA and TCE sites. As stated earlier, the IRS does not fund quality reviewers, yet the volunteer sites need them (even in a part-time funded capacity) to ensure the accuracy of returns; TIGTA has consistently noted quality issues in its reports about VITA and TCE sites.<sup>64</sup> Because the programs have to depend on volunteers to verify the quality of the prepared returns, some taxpayers are burdened with improperly prepared returns, possibly causing reduced or delayed refunds, or payment of unnecessary taxes.<sup>65</sup>

In addition to the lack of funding for quality reviewers, the IRS restricts funding of Certified Acceptance Agents (CAAs) at VITA and TCE sites, creating an additional burden to taxpayers who need an Individual Taxpayer Identification Number (ITIN).<sup>66</sup> The National Taxpayer Advocate has drawn attention to issues with the ITIN application process multiple times.<sup>67</sup> Taxpayers who are ineligible for a Social Security

62 This has always been an issue for taxpayers in need of filing returns for immigration reasons. These taxpayers are sometimes required to provide several years of tax returns to meet certain immigration related requirements.

63 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Oct. 20, 2014). IRC § 6651(a)(1), (b)(1). Under IRC § 6651(a)(1), a taxpayer who fails to file a return on or before its due date (including extensions) will be subject to a penalty of five percent of the tax due (minus any credit the taxpayer is entitled to receive and payments made by the due date) for each month or partial month the return is late, up to a maximum of 25 percent, unless the failure is due to reasonable cause and not willful neglect. See also Most Litigated Issue: *Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654*, *supra*.

64 IRM 22.30.1.3.3.1.2, *Compensation for Grant Program* (Oct. 1, 2011). For further information on the accuracy of returns prepared by TACs, see National Taxpayer Advocate 2012 Annual Report to Congress 20-39 (Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*). See TIGTA, Audit No. 201240049, *Additional Steps Are Needed to Ensure the Volunteer Income Tax Assistance Grant Program Reaches More Underserved Taxpayers* (Apr. 30, 2012); TIGTA, Audit No. 201340110, *Inconsistent Adherence to Quality Requirements Continues to Affect the Accuracy of Some Tax Returns Prepared at Volunteer Sites* (Sep. 15, 2013).

65 The IRS monitors the quality of the VITA and TCE sites as part of their participation in the grant programs. Quality is measured and is used to evaluate whether the site receives funding in the future. See IRM 22.30.1.3.13, *Quality Review Process* (Oct. 10, 2013). However, every tax return must be quality reviewed by a person other than the preparer. See IRM 22.30.1.3.13.1(4), *VITA and TCE Quality Site Requirements (QSR)* (Oct. 1, 2013).

66 A certified acceptance agent is a person (i.e., an individual or an entity) who, is authorized to assist alien individuals and foreign persons in obtaining ITINs from the IRS. Rev. Proc. 2006-10, 2006-2 IRB 293 (released Jan. 9, 2006).

67 See 2013 Annual Report to Congress 214-227 (Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*); National Taxpayer Advocate 2012 Annual Report to Congress 154-79 (Most Serious Problem: *The IRS's Handling of ITIN Applications Imposes an Onerous Burden on ITIN Applicants, Discourages Compliance, and Negatively Affects the IRS's Ability to Detect and Deter Fraud*); National Taxpayer Advocate 2010 Annual Report to Congress 319-338 (Most Serious Problem: *Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers*); National Taxpayer Advocate 2008 Annual Report to Congress 126-140 (Most Serious Problem: *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*); National Taxpayer Advocate 2004 Annual Report to Congress 143-162 (Most Serious Problem: *Processing Individual Taxpayer Identification Number Applications and Amended Income Tax Returns*); National Taxpayer Advocate National Taxpayer Advocate 2003 Annual Report to Congress 60-86 (Most Serious Problem: *Individual Taxpayer Identification Number (ITIN) Program and Application Process*).

number (SSN) need an ITIN to meet their tax return filing obligations or claim the personal exemptions for spouses and children, and the tax credits and refunds to which they are legally entitled. These taxpayers also need ITINs to have the proper amount of taxes withheld, claim tax treaty benefits, and comply with reporting laws such as the Foreign Account Tax Compliance Act (FATCA).<sup>68</sup>

The problems facing ITIN taxpayers include forgoing filing a joint return and claiming exemptions, possibly resulting in the payment of more taxes than are legally due; and the hardship associated with mailing original documents to the IRS for an extended period (often many months), risking fines and incarceration in some locations, or lost documents by the IRS resulting in high replacement costs.<sup>69</sup> Having a paid CAA on staff at the VITA or TCE site would allow certification of documents that taxpayers bring in with their Form W7, *Application for IRS Individual Taxpayer Identification Number*, thus reducing the burden to taxpayers. It would also promote accountability and protect against fraud. The IRS's policy of not funding quality reviewers and CAAs undermines the meaning and value of the rights *to quality service*, and *to pay no more than the correct amount of tax*.

As discussed above, IRS restrictions on how the VITA and TCE sites use their funds limit the effectiveness and reach of both programs. Absent these restrictions, the IRS could develop an infrastructure that:

- Allows the VITA and TCE sites to assist more taxpayers in need (especially the hard-to-serve taxpayer communities that Congress intended the VITA program to help);
- Encourages the VITA and TCE sites to provide year-round services, as taxpayers need return preparation assistance year-round and not just during the January-April filing season; and
- Minimizes enforcement costs resulting from noncompliant taxpayers having no place to go to get free tax return preparation services that are easily accessible, or turning to unregulated and incompetent (or unscrupulous) return preparers for assistance.<sup>70</sup>

## CONCLUSION

The IRS's approach to VITA and TCE programs, in a time of significant reductions in face-to-face service, increases taxpayer burden and may adversely and significantly impact voluntary compliance, a result Congress wanted to avoid. Between elimination of tax preparation services at TACs, increased VITA and TCE activity, inadequate funding of the VITA grant program, restrictive grant guidelines, and software and volunteer training limitations, the IRS may overburden volunteer program partners and effectively eliminate any expectations that low income, disabled, rural, and elderly taxpayers can obtain free tax return preparation services. The IRS should refocus on the congressional intent behind VITA and TCE programs and tailor its administration of these programs to the specific needs of underserved taxpayer populations.

68 See National Taxpayer Advocate 2013 Annual Report to Congress 238-48 (Most Serious Problem: *Reporting Requirements: The Foreign Account Tax Compliance Act has the Potential to be Burdensome, Overly Broad, and Detrimental to Taxpayer Rights*).

69 National Taxpayer Advocate 2013 Annual Report to Congress 214-27 (Most Serious Problem: *INDIVIDUAL TAXPAYER IDENTIFICATION NUMBERS: ITIN Application Procedures Burden Taxpayers and Create a Barrier to Return Filing*).

70 For a more detailed description of return preparer misconduct and IRS efforts to regulate them, see National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *REGULATION OF RETURN PREPARERS: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-78 (*IRS Steps to Create a Voluntary Program for Tax Return Preparer Standards in Light of the Loving Decision Are Well Intentioned, But the Absence of a Meaningful Competency Examination Limits the Program's Value and Could Mislead Taxpayers*).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Increase VITA funding to maximize the overall resources (federal and matching funds) available for free tax preparation assistance.
2. Remove VITA and TCE program grant restrictions for specific tax forms, schedules, and issues, including Schedules C, D, and F, and ITINs.
3. Allow grant funding for quality review, CAAs, and year-round services at select sites.
4. Require volunteers who are authorized under Circular 230 to practice before the IRS (*i.e.*, attorneys, CPAs, and Enrolled Agents) to annually recertify only on new provisions and changes in tax law.
5. Provide free tax preparation assistance at TACs in areas with limited access to VITA or TCE volunteers, along with proper staffing and hours to handle taxpayer traffic.

**MSP  
#6****HEALTH CARE IMPLEMENTATION: Implementation of the Affordable Care Act May Unnecessarily Burden Taxpayers****RESPONSIBLE OFFICIALS**

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**DEFINITION OF PROBLEM**

The Patient Protection and Affordable Care Act of 2009 (ACA) was enacted by Congress in 2010 to provide affordable health care coverage for all Americans. To accomplish this goal, the ACA provides targeted tax credits for low income individuals and for small businesses, while imposing a personal responsibility on individuals to have health coverage.<sup>1</sup>

Since enactment, the IRS has been implementing complicated ACA provisions that require developing or updating information technology systems, issuing guidance, and collaborating with other federal agencies. The true test for the IRS and individual taxpayers begins in 2015, when taxpayers filing tax year (TY) 2014 federal income tax returns have to report that they have “minimum essential coverage” or are exempt from the responsibility to have the required coverage. If the taxpayer does not have coverage and is not exempt, he or she must make a shared responsibility payment (SRP) when filing a return.<sup>2</sup> Additionally, many taxpayers will have to reconcile the Premium Tax Credit (PTC) amounts they received in advance with the amounts to which they are entitled.<sup>3</sup> At the same time, the IRS will receive and process a significant amount of new information returns from employers, insurers and exchanges.<sup>4</sup>

Through representation on the IRS ACA Executive Steering Committee and several joint implementation teams, the National Taxpayer Advocate and Taxpayer Advocate Service (TAS) have identified the following concerns with ACA procedures and implementation:

- Delays in implementing health care procedures have impacted the training of IRS employees;

1 Internal Revenue Code (IRC) § 4980H(a)(1) also imposes a responsibility for applicable large employers to offer health care to employees in certain circumstances. Patient Protection & Affordable Care Act of 2009, Pub. L. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care & Education Reconciliation Act of 2010 (HERCA), Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010); Senate Finance Committee, *Description of Policy Options: Expanding Health Care Coverage: Proposals to Provide Affordable Coverage to All Americans* (May 14, 2009).

2 IRC § 5000A.

3 The Premium Tax Credit is a refundable tax credit paid both in advance and at return filing to help taxpayers with low to moderate income purchase health insurance through the marketplace. IRC § 36B. As explained below, the amount of the credit paid in advance is based on projected income, while the amount for which a taxpayer is actually eligible is based on actual income.

4 The Health Insurance Marketplace, also called the “Exchange,” is a state or federally operated program where individuals can buy health care coverage. Coverage is available to people who are uninsured or buy insurance on their own. See <http://www.irs.gov/uac/Newsroom/The-Health-Insurance-Marketplace>. IRC § 6055 requires annual information reporting by health insurance issuers, self-insuring employers, government agencies, and other providers of health coverage. Section 6056 requires annual information reporting by applicable large employers relating to the health insurance that the employer offers (or does not offer) to its full-time employees. IRS Notice 2013-45, 2013-31 IRB 116, provides transition relief but the IRS has encouraged entities to voluntarily provide information returns for coverage provided in 2014, which are due to be filed and furnished in early 2015.

- IRS outreach and education should continue to focus on increasing taxpayer awareness of the need to update information with the exchanges throughout the year;
- Problems with state calculations of the advanced PTC and delays in processing PTC Change in Circumstances information can result in inaccurate advanced PTC payments and thereby harm taxpayers;
- The inability of the IRS to adequately test the accuracy of information-reporting data before the filing season can inhibit IRS verification efforts and cause significant taxpayer burden;
- The IRS may take inappropriate collection actions on shared responsibility payment liabilities;
- The use of “combination letters” for a disallowed PTC may confuse taxpayers;
- The inability of health insurers and self-insured employers to match tax identification numbers (TINs) before filing their information returns may lead to mismatches and unnecessary notices; and
- The IRS should provide additional guidance to employers on how to calculate the number of full-time equivalents for purposes of meeting the minimum essential coverage requirements.

Notwithstanding these concerns, we acknowledge the tremendous efforts made by the IRS to implement the healthcare provisions given their interdependency on decisions made by other federal agencies. Because the IRS’s role is downstream of many external reporting processes, taxpayers and the IRS may experience problems over which the IRS has no control. Yet, the IRS will certainly bear much of the public blame because many of the problems will arise in the context of return filing. Conversely, taxpayers and the IRS will experience problems created specifically by IRS policies or processes, some of which are exacerbated by the general reduction in funding for taxpayer service.<sup>5</sup>

## ANALYSIS OF PROBLEM

### Background

#### *Shared Responsibility Payment*

Beginning in January 2014, non-exempt U.S. citizens and legal residents are required to maintain minimum essential coverage<sup>6</sup> or be subject to a shared responsibility payment (SRP).<sup>7</sup> The individual shared responsibility provision (ISRPP) of the ACA phases in the amount of the payment until tax year (TY) 2016, when the payment amount will be the greater of:

1. 2.5 percent of household income for the taxable year over the threshold amount of income required for tax return filing for that taxpayer under § 6012(a)(1); or
2. \$695 per uninsured adult in the household and indexed for inflation thereafter.

5 For a discussion of the reduction in taxpayer services, see Most Serious Problem: *TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, *supra*. For a discussion of how the IRS should prioritize taxpayer services, see Most Serious Problem: *TAXPAYER SERVICE: Due to the Delayed Completion of the Service Priorities Initiative, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions*, *supra*.

6 Minimum essential coverage includes government-sponsored programs, eligible employer-sponsored plans, plans in the individual market, grandfathered group health plans and other coverage as recognized by the Secretary of Health and Human Services (HHS) in coordination with the Secretary of the Treasury. IRC § 5000A(f).

7 Individuals are exempt from the requirement for months they are incarcerated, not legally present in the United States, or maintain religious exemptions. IRC § 5000A(d).

If an uninsured individual in the household has not attained the age of 18 as of the beginning of a month, the penalty amount for that individual for the month is equal to one-half of the applicable dollar amount for the calendar year in which the month occurs.<sup>8</sup> For TY 2014, the phased-in amount is the greater of (1) one percent of excess household income or (2) \$95 per uninsured adult in the household.<sup>9</sup>

The SRP is considered an excise tax that is assessed in the same manner as an assessable penalty under the enforcement provisions of the Code. While the IRS has the authority to offset refunds or credits to collect the SRP, it does not have the authority to collect through the use of liens and seizures. Moreover, noncompliance with the SRP requirement to have health coverage is not subject to criminal or civil penalties under the Code.<sup>10</sup>

### *Premium Tax Credit*

Individuals and families who purchase health insurance through an exchange may be eligible for the PTC (also called the “premium assistance credit”), which subsidizes the purchase of certain health insurance plans through an exchange.<sup>11</sup> The credit is refundable and payable in advance directly to the insurer. It is available for individuals (single or joint filers) who have household incomes between 100 and 400 percent of the federal poverty line (FPL) for the family size involved and who do not receive health insurance through an employer or a government-sponsored program.<sup>12</sup>

When applying for the credit, the individual must submit income and family size information to the exchange.<sup>13</sup> During the open enrollment period, participants must provide an estimate of their projected household income based on their most recently filed income tax return and any anticipated changes to income in the upcoming year. The exchange can verify data with the Department of Health and Human Services (HHS), which has authority under the ACA to obtain limited IRS data, and then disclose any inconsistency to the exchange.<sup>14</sup> The IRS provides limited tax return information to the marketplace, using the latest tax return information relevant to the healthcare coverage year.

The IRS data used is typically two years prior to the coverage year at issue.<sup>15</sup> For example, during the open enrollment season for 2015, which runs from November 15, 2014, through February 15, 2015, an applicant estimates projected 2015 household income to the exchanges, which typically involves looking at the most recently filed tax return (in this case usually TY 2013) with modifications to reflect any projected changes for 2015.<sup>16</sup> The exchange then verifies, via the Department of Health and Human Services (HHS), the taxpayer’s projected 2015 household income against IRS records based on the taxpayer’s most

8 IRC § 5000A(c)(3)(C).

9 IRC § 5000A(c)(2)(B)(i) & (c)(3)(B).

10 IRC § 5000A(g); J. Comm. on Tax’n, *Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” as Amended, in Combination with the “Patient Protection and Affordable Care Act,”* JCX-18-10 31 2 (Mar. 21, 2010).

11 The Health Insurance Marketplace, also called the “Exchange,” is a state or federally operated program where individuals can buy health care coverage. Coverage is available to people who are uninsured or buy insurance on their own. See <http://www.irs.gov/uac/Newsroom/The-Health-Insurance-Marketplace>.

12 IRC § 36B; J. Comm. on Tax’n, *Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” as Amended, in Combination with the “Patient Protection and Affordable Care Act,”* JCX-18-10 17 (Mar. 21, 2010).

13 See ACA § 1411(b), 124 Stat. 119, 224 (2010).

14 See IRC § 6103(l)(21).

15 IRC § 6103(l)(21). The Treasury Inspector General for Tax Administration (TIGTA) conducted a review of the IRS’s response to 101,018 income and family size verification (IFSV) information requests received by the IRS between October 1 and October 4, 2013, and found that the IRS provided accurate responses for 100,985 (99.97 percent) of the 101,018 requests. TIGTA, Ref. No. 2014-43-044, *Affordable Care Act: Accuracy of Responses to Exchange Requests for Income and Family Size Verification Information and Maximum Advance Premium Tax Credit Calculation* (July 3, 2014).

16 See <https://www.healthcare.gov/income-and-household-information/>.

recently processed tax return, typically TY 2013 in this case.<sup>17</sup> If IRS information is outdated due to the time difference, the individual may need to provide updated documentation or other evidence to the exchange to establish eligibility for the PTC.

The eligibility for and amount of the PTC are determined in advance of the coverage year, on the basis of:

1. Projected household income and family size; and
2. The monthly premiums for qualified health plans in the individual market in which the taxpayer, spouse and any dependent enroll in an exchange.

Any advanced PTC amount is paid during the year by the federal government to the insurer to offset the cost of the individual's insurance premiums.<sup>18</sup>

In the filing season for the tax year in question (for example, the 2015 filing season for TY 2014 returns), the individual taxpayer must reconcile the amount of any advanced PTC on the tax return with the allowable total credit for the year of coverage, based on that coverage year's *actual* household income, family size, and premiums. Any adjustment to tax resulting from the difference between the advance payment amount and the total allowable credit would be assessed as additional tax, subject to a repayment limitation, or a reduction in tax on the return.<sup>19</sup>

### Delays in Implementing New Health Care Procedures Have Impacted the Training of IRS Employees.

The new work caused by the ACA will likely exacerbate the IRS's already low level of service on its phone lines, as well as increasing the backlog of correspondence from taxpayers.<sup>20</sup> The IRS has estimated that it needs more than 2,300 employees to handle ACA implementation requirements, additional calls, and correspondence. However, the IRS has not received funding for these necessary additional hires.<sup>21</sup>

The IRS also must ensure that employees who work ACA-related issues, especially those in taxpayer-facing roles, are properly trained. In general, the IRS has worked diligently to develop and deliver a substantial amount of training on schedule.<sup>22</sup>

17 IRC § 36B; J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act,"* JCX-18-10 17 (Mar. 21, 2010).

18 If a taxpayer's household status at year's end is other than anticipated—due to a change in income or family size—the Premium Tax Credit may be more or less than the amount advanced. Consequently, the IRS may recover the excess as a tax, subject to a repayment limitation, or owe the taxpayer a refund. IRC § 36B(f)(2)(B); Treas. Reg. §1.36B-4(a)(3).

19 Taxpayers are not required to claim the PTC in advance. They can claim the PTC on the tax return instead. The PTC is a refundable credit and either reduces their tax liability or increases their refund. IRC § 36B. The repayment of any additional tax computed during the reconciliation may be limited if the taxpayer's household income is less than 400 percent of the Federal poverty line. Treas. Reg. §1.36B-4(a)(3). J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in combination with the "Patient Protection and Affordable Care Act,"* JCX-18-10 17 (Mar. 21, 2010). TAS was initially concerned that the existence of separate verification systems to process ACA items on the return would lead to either delays in processing or the issuance of multiple notices. However, we have been assured that ACA computer systems will not impose greater burdens on taxpayers. IRS response to TAS fact check (Dec. 23, 2014).

20 National Taxpayer Advocate 2013 Annual Report to Congress 20; National Taxpayer Advocate 2012 Annual Report to Congress 34.

21 Affordable Care Act (ACA) Program Management Office, ACA Enterprise Integrated Program Plan & Risk Register Executive Reports 7 (Oct. 31, 2014). For FY 2014, W&I had 180 full time equivalent employees (FTEs) working on ACA implementation and planned to have 2,358 FTEs for FY 2015. W&I response to TAS information request (Oct. 28, 2014).

22 Summary of Affordable Care Act Training Plans for W&I, W&I response to TAS information request (Oct. 28, 2014).

However, delays in implementation have impacted training for certain ACA topics. For example, it is our understanding that delays in the development of the 1094 and 1095 series forms and instructions have also delayed the associated training of employees.<sup>23</sup> These forms provide information-reporting data from the exchanges and employers regarding taxpayer's minimum essential coverage. Forms 8962 and 8965—on which taxpayers claim and reconcile the PTC and claim an exemption from the SRP, respectively, were only finalized on November 13, 2014 and their instructions were not finalized as of December 29, 2014. These documents are the basis of the majority of IRS training for W&I employees, and the IRS was forced to roll out its training without final forms and instructions. If IRS employees are not properly trained on these forms, they may not be able to accurately determine a taxpayer's liability for the SRP or verify eligibility for the PTC.

### IRS Outreach and Education Should Focus on Increasing Taxpayer Awareness of the Need to Update Information with the Exchange Throughout the Year.

During the 2015 filing season, many taxpayers will need to reconcile the advanced PTC amounts they received in 2014 (based on *projected* 2014 income) with the credit amounts to which they are entitled (based on *actual* TY 2014 income).<sup>24</sup> We commend the IRS for focusing on educating taxpayers about the importance of updating their information throughout the year with the exchange if they are receiving the advance credit. To avoid complications associated with receiving an excess credit, taxpayers must update their information with the exchange if their income or other relevant circumstances change. In the future, during each tax year, we urge the IRS to educate taxpayers early and repeatedly about this requirement to prevent them from owing money to the IRS (or reducing their refunds) or claiming too little advanced credit.<sup>25</sup> Although almost 80 percent of individual returns are refund returns, in which the IRS may offset some or all of a reconciliation PTC amount (resulting in a reduced credit), the IRS still should do all it can to ensure that as few taxpayers as possible have excessive advanced PTC payments and instead receive the correct amount throughout the year.<sup>26</sup>

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Because the IRS's role is downstream of many external reporting processes, taxpayers and the IRS may experience problems over which the IRS has no control. Yet, the IRS will certainly bear much of the public blame because many of the problems will arise in the context of return filing.

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The Taxpayer Advocate Service has developed an estimator to help taxpayers and practitioners understand how changes in circumstances will impact their PTC amounts.<sup>27</sup>

23 There were late revisions made to Forms 1094-B, *Transmittal of Health Insurance Coverage Information Returns*; 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*; 1095-B, *Health Coverage*; and 1095-C, *Employer-Provided Health Insurance Offer and Coverage*. Affordable Care Act (ACA) Program Management Office, *ACA Enterprise Integrated Program Plan & Risk Register Executive Reports 4* (Oct. 31, 2014). The Forms 1094 and 1095 B and C are voluntary for TY 2014 and are not used during the filing of the tax returns. IRS response to fact check (Dec. 23, 2014).

24 The Premium Tax Credit is a refundable tax credit (which may be payable in advance) available to help certain low and moderate income taxpayers purchase health insurance through a marketplace. IRC § 36B. Taxpayers will reconcile the advanced PTC with the actual PTC claimed on IRS Form 8962, *Premium Tax Credit (PTC)*.

25 The IRS has developed Publication 5152, *Report Changes to the Marketplace as They Happen*. Other IRS publications explaining the Premium Tax Credit include Publication 5120, *Facts About the Premium Tax Credit* (flyer), and Publication 5121, *Facts About the Premium Tax Credit* (brochure).

26 IRS Compliance Data Warehouse, *Individual Returns Transaction File Tax Year 2012* (June 2014).

27 Available at <http://www.taxpayeradvocate.irs.gov/Individuals/Affordable-Care-Act>.

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While the IRS raises awareness about the taxpayer's need to report Premium Tax Credit changes in circumstances to the exchanges, at least one state exchange experienced delays in processing this information, and was even forced to manually process such requests. When an exchange delays its processing for a significant time, the longer the delay, the more inaccurate the advanced Premium Tax Credit amount might become.

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In addition, taxpayers may have their refunds delayed if, due to an unreported change in circumstances, they claim a larger PTC on their returns than what was advanced to the insurance company during the year. If the IRS flags these returns as potentially fraudulent, it may hold up the PTC portion of legitimate refunds, which TAS has seen happen with other refundable credits, especially when large dollar amounts are at stake.<sup>28</sup> While there is always a risk of individuals trying to game the system, the risk of fraud may be lower with the PTC than with other credits because the advance credit amount is paid directly by the federal government to established insurance companies once the policy is actually in place. The IRS will also be able to verify coverage and premiums amounts through third-party information reporting, assuming the reports are accurate and timely.

After taxpayers file their TY 2014 returns, TAS will explore whether the IRS could have alleviated burden by identifying earlier any discrepancies between income reported on taxpayers' health care applications and income actually reported on their TY 2013 returns. When taxpayers applied for coverage through the exchanges in 2014, the exchanges verified taxpayers' reported projected household income by using IRS data for TY 2012. However, a substantial portion of the more recent TY 2013 data may be available months before the 2015 filing season. We plan to use 2015 filing season data to evaluate whether the use of soft notices sent in 2014 based on TY 2013 return data would have been an effective way to inform taxpayers that they potentially need to report their change in circumstances to the exchange, based on information reported on their most recently filed tax return. The sooner the taxpayers are aware of any income discrepancies, the sooner they can address the issue.

### **Problems with State Calculations of Advanced PTC Amounts and Delays in Processing PTC Change in Circumstances Information Can Result in Inaccurate Advanced PTC Payments and Thereby Harm Taxpayers.**

While the IRS raises awareness about the taxpayer's need to report PTC changes in circumstances to the exchanges, at least one state exchange experienced delays in processing this information, and was even forced to manually process such requests.<sup>29</sup> When an exchange delays its processing for a significant time, the longer the delay, the more inaccurate the advanced PTC amount might become. If the advanced PTC amount is too high, the taxpayer could have an unwelcome surprise and owe money when reconciling the advanced amount with the actual allowable PTC on the TY 2014 return. Again, this is a circumstance completely out of the IRS's control. However, the IRS will share the public blame when this pattern occurs during the 2015 filing season.

28 See National Taxpayer Advocate 2012 Annual Report to Congress 111-13; National Taxpayer Advocate Fiscal Year 2012 Objectives Report to Congress 28-32; National Taxpayer Advocate 2011 Annual Report to Congress 687-89.

29 See, e.g., Taylor Boggs, *Vermont Public Radio, Vermont Health Connect Development Slowed By Contractor Switch, Open Enrollment* (Aug. 29, 2014); Peter Hirschfeld, *Vermont Public Radio, Thousands of Vermont Health Connect Customers Stuck on Service Backlog* (Apr. 21, 2014).

In addition, at least one state exchange calculated the amount of the advanced PTC inaccurately.<sup>30</sup> As a result, some taxpayers will learn about the discrepancy upon reconciling the total advanced payment amount, which was based on projected income, with the total PTC allowed on the tax return, which is based on actual income. In this case, the taxpayer owes additional money through no fault of the taxpayer or the IRS. Although the taxpayer was not in control of the advanced PTC payments paid over to the insurer, the taxpayer may be assessed a negligence penalty or underpayment penalty and have to request abatement for reasonable cause.<sup>31</sup>

### **The Inability of the IRS to Adequately Test the Accuracy of Information-Reporting Data Before the Filing Season Can Inhibit IRS Verification Efforts and Cause Significant Taxpayer Burden.**

The IRS relies on information reports to verify data relevant to the SRP liability and PTC eligibility. However, as of December 26, 2014, the IRS had not completed testing of the data from several state exchanges. As of that same date, the IRS received and tested actual data from the Centers for Medicare and Medicaid Services (CMS), the federal exchange which provides coverage information for the states that did not develop their own exchanges.<sup>32</sup> If the IRS cannot receive data from exchanges accurately and timely, the IRS has little opportunity to identify problems and even less opportunity to fix them. In addition, if the IRS receives incomplete or inaccurate data, it cannot accurately verify coverage, which will inhibit the IRS's ability to verify eligibility for the PTC. In response, the IRS has developed a contingency plan to enable the IRS to continue processing returns.<sup>33</sup> While these contingency procedures will identify questionable returns with possible ACA compliance issues, they may also inadvertently flag some compliant tax returns as well. The extent of this issue will become clear during the 2015 filing season when the IRS actually receives data from the exchanges.

### **The IRS May Take Inappropriate Collection Actions on Shared Responsibility Payment Liabilities.**

The ACA prohibits the IRS from filing a notice of lien or levying to collect any SRP liabilities.<sup>34</sup> The SRP was not enacted to be a revenue raiser. In fact, the Congressional Budget Office (CBO) scored the provision to raise only \$55 billion from 2015 through 2022 as compared to the total estimated cost of the ACA of over \$1.1 trillion through 2022.<sup>35</sup> Rather, the main purpose of the provision was, working in unison with the other core provision of the ACA, to achieve “near-universal” health insurance coverage.<sup>36</sup>

30 ACA Program Office response to TAS information request (Dec. 11, 2014); Cover Oregon, *Advanced Premium Tax Credit (APTC) Update* (Sept. 15, 2014).

31 IRC §§ 6662, 6664(c).

32 As of December 26, 2014, the IRS had not completed testing on the data from the exchanges in the following jurisdictions: Colorado, District of Columbia, Hawaii, Minnesota, and Oregon. ACA Program Office response to TAS information request (Dec. 30, 2014); IRS response to fact check (Dec. 23, 2014). Affordable Care Act (ACA) Program Management Office, *ACA Enterprise Integrated Program Plan & Risk Register Executive Reports 7* (Nov. 28, 2014). As of January 2014, there were 19 state-based marketplaces. <http://www.cms.gov/CCIIO/Resources/Fact-Sheets-and-FAQs/state-marketplaces.html>.

33 Affordable Care Act (ACA) Program Management Office, *ACA Enterprise Integrated Program Plan & Risk Register Executive Reports 5-6* (Oct. 31, 2014).

34 IRC § 5000A(g)(2)(B).

35 Congressional Budget Office, *Estimates for the Insurance Coverage Provisions of the Affordable Care Act Updated for the Recent Supreme Court Decision*, Table 4 (July 2012).

36 See Patient Protection & Affordable Care Act of 2009, Pub. L. 111-148, 124 Stat. 119, §1501(a)(2)(D) (Mar. 2010), as amended by the Health Care & Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010); Brief for State Petitioners on Severability at 11, *National Federation of Independent Business v. Sebelius*, 132 U.S. 2566 (2012) (Nos. 11-393, -400).

In accordance with this public policy, the Act limits the IRS's collection authority with respect to the SRP and currently restricts collection actions to refund offsets.<sup>37</sup>

IRS collection efforts for SRP liabilities may indirectly burden taxpayers. For example, if an installment agreement (IA) defaults due to insufficient payment or any reason other than an outstanding SRP liability, the IRS is currently considering only reinstating the agreement if all tax liabilities, including SRP liabilities, are included.<sup>38</sup> The National Taxpayer Advocate questioned whether the IRS has the legal authority to include SRP liabilities in installment agreements.

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**If the IRS cannot receive data from exchanges accurately and timely, the IRS has little opportunity to identify problems and even less opportunity to fix them.**

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In response to a query from the National Taxpayer Advocate, the Office of Chief Counsel has concluded that the IRS has authority to include SRP in IAs and offers in compromise (OICs). However, the response was issued as a draft “white paper” that is not publicly available.<sup>39</sup> The “white paper” also stated that the IRS is neither precluded from conditioning, nor required to condition, agreements on the inclusion of SRP liabilities. Further, the IRS has the discretion to require terms or conditions that protect the government's interests.<sup>40</sup> Because Chief Counsel's reasoning in this matter potentially affects millions of taxpayers, the National Taxpayer Advocate believes it should be rewritten in the form of Program Manager Technical Advice (PMTA) and released to the public.<sup>41</sup>

The IRS applies IA payments in a manner that will protect the government's best interests.<sup>42</sup> This generally means that the IRS will apply payments to the oldest liability first.<sup>43</sup> However, it is unclear the order in which the IRS will apply payments. It is the position of the National Taxpayer Advocate that any policy to apply payments first to SRP liabilities is inconsistent with the best interest of the government in many cases, and a deviation from established practices. If the IRS applies the payments to the SRP liability first, then it risks the oldest debt becoming unenforceable by virtue of the expiration of the statutory period to collect the tax.<sup>44</sup>

37 IRC § 5000A(g); J. Comm. on Tax'n, *Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act,"* JCX-18-10 31 (Mar. 21, 2010). TAS was initially concerned that the IRS may attempt to apply excess levy proceeds toward SRP liabilities. However, it is our understanding that IRS collection systems have been programmed to prevent such application. In addition, IRM 5.11.2.6, *Disposing of Surplus Proceeds* (Jan. 1, 2015) prohibits such application of surplus levy proceeds to SRP balance due accounts. IRS response to TAS information request (Dec. 15, 2014).

38 Draft IRM 5.19.1.5.4.26, page 23, bullet 4 (Aug. 19, 2014); IRM 5.14.11.5, *Defaulted Installment Agreements: Considerations after Default or Termination, Including Reinstatement* (Jan. 1, 2015).

39 The Office of Chief Counsel sometimes provides legal analysis in the form of a “white paper” when the analysis and conclusions are the result of a collaborative effort among multiple functions. Because this draft “white paper” was meant to guide a discussion of issues and was not a formal legal opinion, it was not released to the public.

40 See Treas. Reg. § 301.6159-1(c)(iii)(B).

41 PMTA is legal advice, signed by attorneys in the National Office of the Office of Chief Counsel and issued to IRS personnel who are national program executives and managers. Although PMTAs are not precedential, they nonetheless are instructive and provide guidance to assist IRS personnel in administering their programs. PMTAs are publicly available in the electronic reading room at <http://www.irs.gov/uac/Electronic-Reading-Room>.

42 See, e.g., IRM 5.14.7.5, *Payments on Trust Fund Accounts During Approved In-Business Trust Fund Installment Agreements* (Aug. 5, 2010); *Concert Staging v. Comm'r*, T.C. Memo. 2011-231 (Sept. 26, 2011).

43 Rev. Proc. 2002-26 applies to OICs and collateral agreements and does not apply to installment agreements. However, as a practical matter, it is generally in the best interest of the IRS to follow the payment application ordering rules of the Rev. Proc. in the majority of cases. Non-designated payments will generally be applied to the oldest liability first. Designated payments will generally be applied as requested by the taxpayer. Rev. Proc. 2002-26, 2002-1 C.B. 746; IRM 5.1.2.8, *Designated Payments* (June 20, 2013).

44 IRC § 6502.

### The Use of “Combination Letters” for Disallowed PTC May Confuse Taxpayers.

The National Taxpayer Advocate is concerned that the IRS will use combination or “combo” letters to notify taxpayers of disallowed PTCs or advanced PTCs that have not been reconciled. These letters, which the IRS sometimes sends in an effort to “streamline” examination processes, merge two distinct audit letters:

1. The initial contact letter; and
2. The 30-day letter that includes the preliminary audit report and describes the taxpayer’s appeal rights.

The National Taxpayer Advocate has consistently opposed the IRS’s use of combo letters.<sup>45</sup> They are confusing because taxpayers do not know whether to respond to the exam and risk forfeiting their appeal rights, file an appeal and risk annoying the examiner, or both.<sup>46</sup> Further, in addition to information about appeal rights, we believe the 30-day letters should include information about TAS and Low Income Taxpayer Clinics (LITCs).<sup>47</sup>

### The Inability of Health Insurers and Self-Insured Employers to Match TINs Before Filing May Lead to Mismatches and Unnecessary Notices.

The IRS has not expanded the tax identification number (TIN) matching program to health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*.<sup>48</sup> The current e-Services TIN Matching Program (TMP) allows participating payers of reportable payments subject to backup withholding under IRC § 3406(b), to match the TIN and name of payees subject to potential backup withholding with IRS records prior to filing the information report.<sup>49</sup> Using the TMP helps payers avoid penalties for submitting incorrect TINs on information returns.<sup>50</sup>

45 Statement of Procedural Rules, § 601.105(d)(1)(iv) authorizes the 30-day letter, which explains the proposed changes and advises the taxpayer of the liability and of the right to file a protest within 30 days to be considered by IRS Appeals. Concerns about the use of the combination letter in Examination were initially raised in the National Taxpayer Advocate’s 2001 Annual Report to Congress 20-22 (Most Serious Problem: *Documenting Earned Income Tax Credit Eligibility*). See also National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 85; National Taxpayer Advocate 2008 Annual Report to Congress 227-59 (Most Serious Problem: *Suitability of the Examination Process*, and Most Serious Problem: *The IRS Correspondence Examination Process Promotes Premature Notices, Case Closures, and Assessments*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2006 Annual Report to Congress 289-310 (Most Serious Problem: *Correspondence Examination*); National Taxpayer Advocate 2005 Annual Report to Congress 94-122 (Most Serious Problem: *EITC Exam Issues*); National Taxpayer Advocate 2004 Annual Report to Congress 163-180 (Most Serious Problem: *Lack of Notice Clarity*); National Taxpayer Advocate 2003 Annual Report to Congress 87-98 (Most Serious Problem: *Combination Letter*); National Taxpayer Advocate 2002 Annual Report to Congress 55-63 (Most Serious Problem: *Procedures of Examining EITC Claims Cause Hardship and Infringe on Appeal Rights*).

46 Combo letters are even more burdensome under Appeals’ new Appeals Judicial Approach and Culture (AJAC) project by which Appeals will not conduct fact-finding and will send the case back to exam for further development, thereby treating the taxpayer like a ping-pong ball. Memorandum for Appeals employees from Director, Policy, Quality and Case Support, IRS Office of Appeals, Implementation of the Appeals Judicial Approach and Culture (AJAC) Project Examination and General Matters—Phase 2, Control No. AP-08-0714-0004 (July 2, 2014).

47 An example of a combo letter used for ACA purposes is Letter 566-B. The notices should provide contact information in addition to brief summaries of the services offered by each organization. Per IRC § 7526, LITCs represent low income individuals in disputes with the Internal Revenue Service, including audits, appeals, collection matters, and federal tax litigation. LITCs can also help taxpayers respond to IRS notices and correct account problems. Some LITCs provide education for low income taxpayers and taxpayers who speak English as a second language (ESL) about their taxpayer rights and responsibilities.

48 IRC § 6055.

49 IRM 5.19.3.4.1.6, *e-Services Taxpayer Identification Number (TIN) Matching Program* (Apr. 23, 2014).

50 The penalty for failure to file a correct information return is generally \$100, and the penalty for failure to furnish a correct payee statement is also generally \$100. IRC §§ 6721, 6722. The IRS will not impose the penalty if the filer shows the failure was due to reasonable cause and not willful neglect. IRC § 6724.

Likewise, TMP would also benefit the filers of Forms 1095-B, which provide the names and TINs of all covered individuals and the months for which they had minimum essential coverage. The IRS will use the forms to verify an individual's compliance with the ISRP. The reporting entities are not required to file the forms until the 2016 filing season.<sup>51</sup>

However, many Form 1095-B filers have never had to verify the accuracy of the name/TIN information, and the inability to verify the information before issuing the forms could cause inaccurate TIN reporting. If information returns with incorrect or incomplete names or TINs are submitted (because the issuers are not able to run the numbers through the IRS TIN matching program before filing), the IRS will not be able to verify that the individuals have minimal essential coverage. Therefore, even covered individuals could receive notices imposing the SRP or insurers would receive avoidable penalty assessments arising from such mismatches.<sup>52</sup>

### **The IRS Should Expand Its Employer Shared Responsibility Q&A Page to Provide Additional Guidance to Employers on How to Calculate the Number of Full-Time Equivalents for Purposes of Meeting the Minimum Essential Coverage Requirements.**

Employers not in compliance with the provisions under IRC § 4980H may be subject to an assessable payment, referred to as the “employer shared responsibility payment” (ESRP). Section 4980H(a)(1) provides that an applicable large employer (ALE) must offer minimum essential coverage to its full-time employees. In general, an employer is considered an ALE if it employs 50 or more full-time workers (or full-time equivalents (FTE)).<sup>53</sup> The ESRP provisions generally are not effective until January 1, 2015, meaning that no ESRP will be assessed for the 2014 tax year.<sup>54</sup> Under the statute, an employee is deemed full-time for a calendar month, if he or she averages at least 30 hours of work per week.<sup>55</sup>

On February 12, 2014, the IRS and Treasury issued final regulations on the ESRP provisions.<sup>56</sup> The guidance acknowledges that there are certain categories of employees whose hours of service will be particularly challenging to identify and track, and advises their employers to use “a reasonable method of crediting hours of service that is consistent with section 4980H.” While far from comprehensive, the preamble does provide good examples of what may be considered a reasonable method in certain industries.

In addition to the final regulations, the IRS provides additional guidance in the form of an ESRP Q&A page on IRS.gov.<sup>57</sup> While it contains helpful information, the limited Q&A page does not adequately address many questions about the calculation of FTEs for purposes of meeting the minimum essential

51 Notice 2013-45, 2013-31 IRB 116; T.D. 9660, 2014-13 IRB 842 (Mar. 24, 2014). Reporting entities will not be subject to penalties for failure to comply with the IRC § 6055 reporting requirements for coverage in 2014 (including the provisions requiring the furnishing of statements to covered individuals in 2015 with respect to 2014). Accordingly, a reporting entity will not be subject to penalties if it first reports beginning in 2016 for 2015 (including the furnishing of statements to covered individuals).

52 Michael M. Lloyd and S. Michael Chittenden, *Expand TIN Matching Program to Avert Another ACA Debacle*, TAX NOTES TODAY (Jan. 15, 2014).

53 IRC § 4980H(c)(2).

54 Notice 2013-45, 2013-31 I.R.B. 116.

55 IRC § 4980H(c)(4).

56 Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), available at <https://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage>.

57 See <http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-Employer-Shared-Responsibility-Provisions-Under-the-Affordable-Care-Act#Identification> (last visited Dec. 2, 2014).

coverage requirements. The IRS cannot realistically be expected to post answers to every possible scenario, but it should expand this page. For example:

- What would be a reasonable method of determining FTE for clergy who have not taken a vow of poverty?<sup>58</sup> Members of religious orders often have responsibilities that do not fit a typical “9 to 5” schedule. Arriving at hours to include in the calculation of FTE seems problematic for such a profession.
- What would be a reasonable method of determining FTE for commission-based salespersons? If a significant portion of a salesperson’s compensation comes from commissions, and the employer does not require (or track) a certain number of hours to be worked, determining FTE could be problematic.
- What would be a reasonable method of determining FTE for pilots? Even full-time pilots generally have a good deal of downtime, so hours in the air may not be an ideal way of determining FTE. How would an employer count a pilot who is available for three flights a month for purposes of the FTE calculation for the small business health care tax credit (SBHCTC)?

To educate and assist small business taxpayers, TAS developed an online estimator for the SBHCTC.<sup>59</sup>

This tool allows small businesses to estimate their credits (if any) and find out how any changes in circumstances will impact their eligibility. Since November 2012, we have placed the SBHCTC estimator on the TAS Tax Toolkit,<sup>60</sup> where small businesses and tax professionals can access it easily, and have continually promoted the estimator through social media, including Twitter and Facebook.<sup>61</sup>

## CONCLUSION

The IRS has made tremendous progress, considering the monumental task of implementing and administering the many complicated tax provisions of the ACA. The new systems and procedures developed for ACA administration will be tested beginning in the 2015 filing season when individual taxpayers file their TY 2014 returns, report SRP liabilities, and claim or reconcile PTC. At the same time, the IRS will receive and process a significant amount of new information returns from insurers and exchanges to identify errors and noncompliance. While the IRS has little control over some of the anticipated risks, such as delayed or inaccurate data reporting from the exchanges, it will be held publicly responsible when the associated problems surface during the tax return filing process. In addition, the IRS bears

58 Until further guidance is issued, a religious order is not required, for purposes of determining if an employee is a full-time employee for the ESRP, to include as an hour of service any work performed by clergy who have taken a vow of poverty when the work is in the performance of tasks usually required of an active member of the order. See Treas. Reg. § 54-4890H, 79 FR 8543 (Feb. 12, 2014), available at <https://www.federalregister.gov/articles/2014/02/12/2014-03082/shared-responsibility-for-employers-regarding-health-coverage>.

59 The estimator is available at <http://www.taxpayeradvocate.irs.gov/Businesses/Small-Business-Health-Care-Tax-Credit-Estimator>.

60 The TAS Tax Toolkit is a website that contains useful tax information for individuals, businesses, tax professionals and media, including news and updates, ways TAS helps taxpayers, and important information about tax topics and rights and is available at <http://www.taxpayeradvocate.irs.gov/>.

61 The IRS linked to the estimator on IRS.gov and the Kaiser Permanente health care company placed a link to the estimator on its website. On March 10, during the 2014 filing season, the IRS placed a link to the estimator in a news release on helpful resources and tax tips. See <http://www.irs.gov/uac/Newsroom/IRS-Encourages-Small-Employers-to-Check-Out-Small-Business-Health-Care-Tax-Credit-Helpful-Resources-Tax-Tips-Available-on-IRS.gov>. After the new release, the number of views increased from a quarterly average of 110 per day to 1,502 and 483 for March 10 and March 11, respectively. The estimator introduction page has received high traffic overall so far in fiscal year 2014, with 30,990 views through May 2014, an average of over 3,800 per month. Weber Shandwick, *TAS Electronic Toolkit Usage Report* (Oct. 2013–May 2014).

sole responsibility for other anticipated risks, such as possible inappropriate collection actions taken with respect to the SRP.

The 2015 filing season will potentially be the most challenging in several decades and it occurs in a context of historically low levels of taxpayer service. Because of the great risk of taxpayer harm this filing season, TAS will continue to address issues as they arise and identify systemic problems. In fact, TAS will create an ACA Rapid Response team to immediately address any potential ACA systemic issues that arise during the 2015 filing season. In addition, we encourage both internal and external stakeholders to report any suspected ACA systemic issues on TAS's Systemic Advocacy Management System (SAMS).<sup>62</sup>

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS take the following actions:

1. Educate taxpayers early and repeatedly about the requirement to update their information throughout the year with the exchange, if they are receiving the advanced PTC, to prevent them from owing money to the IRS (or reducing their refunds) or qualifying for too little advance credit during the year.
2. For those installment agreements, partial pay installment agreements, and offers in compromise including SRP liabilities, apply payments to the oldest liability first to protect the government's best interests.
3. Reissue the current white paper addressing the IRS's authority to include SRP liabilities in installment agreements and offers in compromise in the form of Program Manager Technical Advice to be released to the public.
4. Include information about TAS and Low Income Taxpayer Clinics in 30-day letters that include both the preliminary audit report and describe the taxpayer's appeal rights.
5. Expand the tax identification number matching program to include health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*.
6. Provide additional guidance to employers on how to calculate the number of full-time equivalents for purposes of meeting the minimum essential coverage requirements.

62 Stakeholders can report suspected systemic issues at: <http://www.irs.gov/Advocate/Systemic-Advocacy-Management-System-SAMS>.

**MSP  
#7****OFFSHORE VOLUNTARY DISCLOSURE (OVD): The OVD Programs Initially Undermined the Law and Still Violates Taxpayer Rights****RESPONSIBLE OFFICIALS**

John A. Koskinen, Commissioner of Internal Revenue  
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 Karen Schiller, Commissioner, Small Business/Self-Employed Division  
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**DEFINITION OF PROBLEM**

Between 2009 and 2014, the IRS generally required “benign actors”—people who inadvertently failed to report offshore income and file one or more related information returns (*e.g.*, the *Report of Foreign Bank and Financial Accounts* (FBAR))—to enter into a punitive offshore voluntary disclosure (OVD) program and either pay an “offshore penalty” designed for “bad actors” or “opt out” and be examined.<sup>1</sup> Inside the 2011 OVD programs, taxpayers with small accounts paid over eight times the unreported tax—over ten times the 75 percent penalty for civil tax fraud—and those who were unrepresented generally paid even more.<sup>2</sup>

Because violations by taxpayers who have small accounts or who do not obtain representation are more likely to have been inadvertent, the OVD programs undermined the statutory scheme, which applies a higher penalty to “willful” violations than to those that are not willful or are due to “reasonable cause.”<sup>3</sup> Some benign actors did not opt out because the cost of representation in a post-opt-out examination could exceed the “offshore penalty.” Others did not opt out because the IRS’s broad discretion in applying penalties outside the OVD programs was too frightening.

In addition, the IRS’s seemingly arbitrary and one-sided interpretations of the OVD frequently asked questions (FAQs)—interpretations that the IRS would not explain and that were not published or subject to appeal—eroded confidence that the IRS would be reasonable in a post-opt-out examination. Thus, the IRS’s OVD programs turned the statutory scheme on its head while eroding trust for the IRS and eroding

- 1 IRS, *Voluntary Disclosure: Questions and Answers*, <http://www.irs.gov/uac/Voluntary-Disclosure:Questions-and-Answers> (posted May 6, 2009) [hereinafter “2009 OVDP FAQ”]; IRS, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, <http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers> (posted Feb. 8, 2011) [hereinafter “2011 OVDP FAQ”]; IRS, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers> (posted June 26, 2012) [hereinafter “2012 OVDP FAQ,” or collectively the “OVD programs”]. For several years, the National Taxpayer Advocate and other stakeholders have expressed concerns about the OVD programs. See, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress 228-238; National Taxpayer Advocate 2012 Annual Report to Congress 134-153; National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *id.* at 21-29 [collectively, *OVD Reports*].
- 2 AIMS Closed Case Database and the Individual Master File Transaction History (Aug. 29, 2014) (TAS analysis of closed case data where an offshore penalty was assessed inside the 2011 OVD program); IRC § 6663 (civil fraud penalty). This is more than the nearly 600 percent they paid under the 2009 OVD program. National Taxpayer Advocate 2013 Annual Report to Congress 228-238. Thus, the 2011 program appears to have exacerbated the disproportionality of the offshore penalty.
- 3 See 31 U.S.C. § 5321(a)(5).

taxpayer rights, such as the rights *to pay no more than the correct amount of tax, challenge the IRS's position and be heard, appeal an IRS decision in an independent forum, and to a fair and just tax system.*<sup>4</sup>

Recent changes to the OVD programs address some of these concerns. However, unlike the last time the IRS made taxpayer-favorable changes to an OVD program, the IRS will not allow those who already agreed to pay disproportionate offshore penalties to benefit from them. Moreover, the IRS has not formally asked for comments or explained why it adopted some suggestions and not others. Nor does it disclose internal guidance (*e.g.*, its counter-intuitive interpretations of FAQs) to the public, eroding the taxpayer *right to be informed.*<sup>5</sup>

The National Taxpayer Advocate is analyzing the OVD programs closely in the context of taxpayer rights because the IRS is likely to use settlement initiatives in the future. Any program that applies an opaque one-size-fits-all approach, as the IRS chose to do with the OVD programs, is likely to produce unfairness and injustice, particularly when taxpayers have diverse facts and circumstances. Thus, this analysis is meant to help improve tax administration efforts going forward.

## ANALYSIS OF PROBLEM

### The penalty for failure to file an FBAR was aimed at criminals and other bad actors.

Under the Bank Secrecy Act (BSA) a U.S. person who owns (or has signature authority over) one or more foreign accounts exceeding \$10,000, during the prior calendar year, can be subject to civil and criminal penalties unless he or she reports the account(s) on an FBAR by June 30.<sup>6</sup> Congress enacted this requirement in 1970 after hearing testimony that criminals were using secret foreign bank accounts for illegal purposes (*e.g.*, tax evasion, securities manipulation, insider trading, evasion of Federal Reserve margin limitations, storing and laundering funds from illegal activities, and acquiring control of U.S. industries without detection by the U.S. Securities and Exchange Commission), and that U.S. law enforcement agencies faced difficulty in obtaining information about these accounts from foreign authorities.<sup>7</sup>

4 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014). For a detailed discussion of taxpayer rights, see National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*).

5 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014). The IRS has issued some clarifications informally. See, *e.g.*, Kristen A. Parillo, *ABA Meeting: More Guidance Coming on Modified OVDP and Streamlined Filing*, 2014 TNT 184-7 (Sept. 23, 2014) (explaining, for example, that even people who do not need to file an amended return could come into the 2014 streamlined program; that although the streamlined program references the instructions to Form 8938, which exclude assets reported on Form 5471, assets reported on delinquent Forms 5471 would nonetheless be included in the penalty base; and that IRS employees had received training regarding willfulness determinations and were using a 'job aid' neither of which would be disclosed to the public). These clarifications were later published as updates to FAQs. See IRS, *Streamlined Filing Compliance Procedures for U.S. Taxpayers Residing in the United States Frequently Asked Questions and Answers* (Oct. 8, 2014) [*hereinafter*, the 2014 streamlined program], <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures-for-U-S-Taxpayers-Residing-in-the-United-States-Frequently-Asked-Questions-and-Answers>.

6 See, *e.g.*, 31 U.S.C. §§ 5314, 5321; 31 C.F.R. §§ 1010.350, 1010.306(c); FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (FBAR), [http://www.fincen.gov/forms/bsa\\_forms/](http://www.fincen.gov/forms/bsa_forms/).

7 See, *e.g.*, Pub. L. No. 91-507, § 241, 242 (1970); S. REP. No. 91-1139 at 2-4, 8-9 (1970); H. REP. No. 91-975 at 12 (1970). Accord H.R. REP. No. 241-3, at 27, 50 (1970) (statement of Robert M. Morgenthau, U.S. Att'y S.D.N.Y.) ("in addition to the usual difficulties attending to the detection of criminal conduct in financial transactions, we have here the added obstacle of the use of secret foreign accounts to avoid discovery... where criminals have made such extraordinary efforts to cover their tracks, we must respond with equal vigor to uncover them."); *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the S. Subcomm. on Financial Institutions, Comm. on Banking and Currency, 91st Cong. 2nd Sess. at 170* (1970) (statement of Eugene T. Rossides, Assistant Secretary of the Treas. for Enforcement and Operations) ("Our overall aim is to build a system to combat organized crime and white collar crime and to deter and prevent the use of secret foreign bank accounts for tax fraud and their use to screen from view a wide variety of criminally related financial activities, and to conceal and cleanse criminal wealth.").

Under the 2011 OVD program, the median offshore penalty for those with the smallest accounts rose to eight times the unreported tax, up from about six times the unreported tax under the 2009 program.

Although a criminal penalty already applied to those who willfully failed to report the existence of a foreign account on Schedule B of a Form 1040, *U.S. Individual Income Tax Return*, Treasury Department officials testified that a less-severe civil penalty would be easier to assert and less likely to violate the U.S. Constitution.<sup>8</sup>

Later, in 2002, the IRS reported to Congress that the FBAR compliance rate was less than 20 percent because about one million U.S. taxpayers may have been required to file FBARs, but the IRS had received fewer than 200,000 filings.<sup>9</sup> Its estimate of required FBAR filings was based in part on the number of credit and debit cards held by U.S. citizens and residents to access funds in offshore accounts. The IRS also cited the difficulty of proving willfulness as one of the reasons why it imposed so few FBAR civil penalties, even against those who intentionally failed to file an FBAR to conceal tax evasion or other crimes.<sup>10</sup>

### Following reports of people intentionally “attempting to conceal income from the IRS,” Congress enacted a non-willful FBAR penalty.

In 2004, Congress dramatically increased the maximum penalty for willful violations and imposed—for the first time—a penalty for non-willful violations.<sup>11</sup> The maximum civil penalty for willful FBAR violations is now 50 percent of the maximum balance in each overseas account for each year of non-reporting (or, if greater, \$100,000 per violation).<sup>12</sup> By contrast, the maximum penalty for non-willful violations is \$10,000.<sup>13</sup> It may be waived if the taxpayer has “reasonable cause” and pays the tax on the income from the account.<sup>14</sup> Legislative history suggests the IRS’s estimate that hundreds of thousands of taxpayers were “attempting to conceal income from the IRS” was a reason for this change.<sup>15</sup> It did not reference a

8 See, e.g., *Foreign Bank Secrecy: Hearings on S. 3678 and H.R. 15073 Before the S. Subcomm. on Financial Institutions, Comm. on Banking and Currency, 91st Cong., 2nd Sess.* at 152 (1970) (statement of Robert Cole, Special Assistant for Int'l Affairs, Treas. Dept.) (“Civil penalties can be imposed administratively and there are cases where it might be appropriate to impose a civil penalty where imposition of a criminal penalty [under IRC § 7203 or IRC § 7206(1)] would seem unduly harsh or could raise evidentiary or constitutional problems.”).

9 U.S. Department of the Treasury, *A Report to Congress in Accordance with § 361(B) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*, 6 (Apr. 26, 2002); IRS Sets New Audit Priorities, FS-2002-12 (Sept. 2002).

10 U.S. Department of the Treasury, *A Report to Congress in Accordance with § 361(B) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001*, 10 (Apr. 26, 2002) (“taxpayers generally assert to the IRS that they were not aware that they were required to file an FBAR. Often, the administrative record lacks evidence to the contrary, such as an advice letter from an accountant or financial planner or any witness to testify that the taxpayer knew of the filing requirement. In such cases the litigation risk in assessing a penalty is substantial, particularly where, after notice from the IRS or FinCEN, the person has voluntarily backfiled the missing forms. Rather than go forward with penalty assessments based on a less than substantial record, FinCEN’s limited resources have been allocated to other compliance and enforcement efforts...”). In January 2003, the IRS offered to settle with persons using offshore payment cards to avoid paying taxes. 2003 IR-2003-5 (Jan 14, 2003); Rev. Proc. 2003-11, 2003-1 C.B. 311.

11 The American Jobs Creation Act of 2004, Pub. L. No. 108-357, Title VIII, § 821(a), 118 Stat. 1586 (Oct. 22, 2004) (amending 31 U.S.C. § 5321(a)(5)).

12 31 U.S.C. § 5321(a)(5). Criminal penalties may also apply to willful violations. 31 U.S.C. § 5322.

13 31 U.S.C. § 5321(a)(5).

14 *Id.*

15 Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 108th Cong., JCS-5-05, 377-378 (2005) (“For one scheme alone, the IRS estimates that there may be hundreds of thousands of taxpayers with offshore bank accounts attempting to conceal income from the IRS.”). See also S. REP. No. 108-11, at 101 (2003) (“attempting to conceal”); S. REP. No. 108-257, at 32 (2003) (same).

concern about taxpayers inadvertently failing to file the form. Thus, even the non-willful FBAR penalty appears to have been aimed at willful violations.

Another penalty of \$10,000 or more may apply if the person does not report the same account on Form 8938, *Statement of Specified Foreign Financial Assets*.<sup>16</sup> Similar information reporting requirements apply to those who own interests in foreign entities.<sup>17</sup> Yet many benign actors who are not criminals (*e.g.*, immigrants, U.S. citizens living abroad, and those who relied on uninformed preparers) have *inadvertently* failed to file these forms.

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The IRS's seemingly arbitrary and one-sided approach to interpreting the OVD FAQs—interpretations that the IRS did not publish, explain, or subject to an appeal—eroded confidence that the IRS would be reasonable in post-opt-out examinations, prompting some benign actors to agree to pay disproportionate offshore penalties.

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### The IRS's effort to apply willful penalties to bad actors has eroded the distinction between willful and non-willful violations.

The IRS may only apply the penalty for willful violations when it can prove willfulness.<sup>18</sup> According to the Supreme Court (and the Internal Revenue Manual or IRM) the IRS may meet its burden to prove willfulness if it shows a violation is a “voluntary, intentional violation of a known legal duty.”<sup>19</sup>

However, the government has eroded the distinction between willful and non-willful violations. Because Schedule B of Form 1040 (*U.S. Individual Income Tax Return*) asks if the taxpayer has a foreign account and references the FBAR filing requirement, the government has been somewhat successful in arguing—in court cases involving bad actors—that in some cases the filing of a Schedule B can turn a subsequent failure to file an FBAR into a willful violation (called “willful blindness”).<sup>20</sup>

The IRS acknowledges that the existence of the checkbox on Schedule B does not turn every FBAR violation into a willful one.<sup>21</sup> However, it suggests that it may do so when the taxpayer has also tried to conceal the account and/or has

16 See IRC § 6038D.

17 See, *e.g.*, Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, Form 5472, *Information Return of a Foreign Owned Corporation*, Form 926, *Return by a U.S. Transferor of Property to a Foreign Corporation*, Form 8921, *Return by a Shareholder of a Passive Foreign Investment Co. or Qualified Electing Fund*, Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships*, Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*, Form 3520-A, *Annual Return of Foreign Trust With a U.S. Owner*, Form 8938, *Statement of Foreign Financial Assets*. The penalty for failure to file these information returns is generally \$10,000 per violation or a percentage of the funds transferred. See generally IRC §§ 6038, 6038B, 6038D, 6039F, 6048. Accord 2012 OVDP FAQ #5. The failure to file these information returns generally means that the statute of limitations for the related income tax return does not begin to run. See IRC § 6501(c)(8). In addition, a 40 percent penalty may apply to the portion of any understatement attributable to a transaction involving an undisclosed foreign financial asset. IRC § 6662(j). Thus, taxpayers who failed to file could be liable for tax underpayments, delinquency penalties, and elevated accuracy-related penalties for many years—liabilities generally avoided under OVD settlement programs. Thus, these rules can increase the risk of severe penalties for those who opt out.

18 31 U.S.C. § 5321(a)(5).

19 *Ratzlaf v. U.S.*, 510 U.S. 135, 142 (1994) (*citing Cheek v. U.S.*, 498 U.S. 192, 201 (1991)); IRM 4.26.16.4.5.3 (July 1, 2008).

20 See, *e.g.*, *Williams v. Comm'r*, 489 Fed. Appx. 655 (4th Cir. 2012) (unpublished) (holding that the filing of Schedule B put the taxpayer on inquiry notice concerning the FBAR filing requirement, turning his continuing ignorance into “willful blindness,” and triggering the willful FBAR penalty); *U.S. v. Sturman*, 951 F.2d 1466, 1477 (6th Cir. 1991) (same); *U.S. v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012) (same).

21 IRM 4.26.16.4.5.3(6) (July 1, 2008) (“The mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness.”).

a large account.<sup>22</sup> The IRS does not identify other relevant factors or provide assurance that it will only pursue a willful penalty against those also engaged in tax shelters, tax evasion, or criminal conduct. As a result, most taxpayers do not know how the IRS will apply this guidance to them. Even a taxpayer who inadvertently overlooked the FBAR filing requirement cannot be sure the violation will be treated as non-willful or due to reasonable cause. Thus, the government's position has likely discouraged benign actors from opting out of the OVD programs and seeking judicial review.

### **It is inconsistent with the statutory scheme for benign actors to pay the same penalty as bad actors.**

The IRM acknowledges that the maximum statutory penalties for “willful” failures to file an FBAR may “greatly exceed an amount that would be appropriate in view of the violation.”<sup>23</sup> Because the statute only specifies the “maximum” FBAR penalty that the IRS “may” impose, it would be inconsistent with the statute for the IRS to assert the maximum penalty in every case.<sup>24</sup>

Moreover, legislative history (cited above) may suggest the IRS should only impose a penalty against those “attempting to conceal income from the IRS,” rather than inadvertent violators.<sup>25</sup> Some commentators have gone so far as to suggest that FBAR penalties can be so disproportionate as to violate the Excessive Fines Clause of the Eighth Amendment to the U.S. Constitution.<sup>26</sup> Thus, it is inconsistent with the statutory scheme for benign actors to pay the same penalty as bad actors.

### **Until recently, the IRS generally required benign actors to enter its OVD settlement programs and pay the same offshore penalty as bad actors or risk “opting out.”**

Between May 6, 2009 and July 1, 2014, the IRS generally required anyone who failed to report offshore income and file an FBAR or other information return to enter into an offshore voluntary disclosure (or OVD) settlement program.<sup>27</sup> Under the 2009 program, these taxpayers were required to pay:

- All unpaid taxes;
- A 20 percent accuracy-related penalty; and
- An “offshore penalty” of 20 percent of their highest offshore account balance (plus foreign assets) during a six-year period (2003-2008).<sup>28</sup>

22 IRM 4.26.16.4.5.3(6) (July 1, 2008) ([after filing a Schedule B,] “the failure to learn of the filing requirements coupled with other factors, such as the efforts taken to conceal the existence of the accounts and the amounts involved may lead to a conclusion that the violation was due to willful blindness.”).

23 IRM 4.26.16.4(5) (July 1, 2008).

24 31 U.S.C. § 5321(a)(5).

25 Indeed, the IRM (quoted above) suggests that the failure to report an account on Schedule B combined with, “efforts taken to conceal the existence of the accounts” may constitute willful blindness. IRM 4.26.16.4.5.3(6) (July 1, 2008). However, it is unclear if the efforts to conceal the accounts must be made with the intent to evade taxes or conceal crimes, rather than reasonable concerns about privacy or unwarranted persecution by a government or others. At a recent American Bar Association (ABA) conference, one IRS employee reportedly expressed the view that a person would not be deemed willful if he was concealing the account to evade foreign taxes. See Kristen A. Parillo, *ABA Meeting: More Guidance Coming on Modified OVD and Streamlined Filing*, 2014 TNT 184-7 (Sept. 23, 2014) (quoting John McDougal as saying “the willfulness we’re trying to determine is with respect to U.S. obligations, not foreign obligations... [if] I’m convinced he had no clue he had to file in the United States, then that seems to me to be the answer to the question”).

26 See Steven Toscher and Barbara Lubin, *When Penalties Are Excessive — The Excessive Fines Clause as a Limitation on the Imposition of the Willful FBAR Penalty*, J. TAX PRACTICE & PROCEDURE 69-74 (Jan. 2010).

27 See, e.g., 2012 OVDP FAQs 15 and 16 (threatening those who make quiet disclosures with examinations and criminal prosecution, and pointedly providing no assurance that these threats do not apply to benign actors); 2009 OVDP FAQs 10 and 49 (same).

28 2009 OVDP FAQs #'s 12, 13, 32, and 33.

The offshore penalty rose to 25 percent of the highest account balance during an eight-year period under the 2011 program, to 27.5 percent under the 2012 program, and up to 50 percent (still over an eight-year period) under the 2014 program.<sup>29</sup> With few exceptions, the OVD programs applied the same offshore penalty to benign and bad actors. The exceptions included:

- A five percent penalty for those holding inactive offshore accounts funded with previously-taxed proceeds and for certain foreign residents;<sup>30</sup>
- A 12.5 percent penalty for those with accounts never exceeding \$75,000;<sup>31</sup> and
- A streamlined program that allowed certain “low risk” foreign residents with a *de minimis* amount of unreported income to avoid the OVD program. However, they could still be deemed “high risk” by the IRS and audited.<sup>32</sup>

Statistics suggest that all or nearly all of the taxpayers who applied to the streamlined programs were benign actors. Between Sept. 1, 2012 and April 24, 2014, the streamlined program attracted 8,851 taxpayers, and only eight percent (or 697 taxpayers) were classified as high risk and examined, as shown by the figure below.

**FIGURE 1.7.1, OVD streamlined program submissions by risk level<sup>33</sup>**

Submissions	Taxpayers	Percent of Total
Classified Low Risk	1,334	15%
Classified High Risk and Examined	697	8%
Subtotal Classified High or Low Risk	2,031	23%
Not Classified by Exam	6,820	77%
<b>Total Submissions</b>	<b>8,851</b>	<b>100%</b>

Even among the “high risk” group, most returns (51 percent) were not changed by the IRS, as shown on the figure below.

29 2014 OVDP FAQ #9; 2012 OVDP FAQ #8; 2011 OVDI FAQ #8.

30 2011 OVDI FAQ #52; 2012 OVDP FAQ #52 (eliminated under the 2014 program).

31 2011 OVDI FAQ #53; 2012 OVDP FAQ #53 (eliminated under the 2014 program).

32 See Form 14438, *Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer* (Aug. 2013); IRS, *Streamlined Filing Compliance Procedures* (Oct. 9, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures> (describing changes to the streamlined program first announced in 2012).

33 IRS response to TAS information request (July 30, 2014) (reflecting submissions received between Sept. 1, 2012 and April 24, 2014). The IRS stopped classifying returns as either high or low risk on June 18, 2014 when it announced the updated streamlined and OVDP programs. IRS response to TAS information request (Dec. 2, 2014). All the tables, charts, and figures in this discussion use numbers that may not add to 100 percent due to rounding.

**FIGURE 1.7.2, Examination results for “high risk” taxpayers on cases closed as of July 15, 2014<sup>34</sup>**

Examination Results	Returns	Percent of Total
No Change	182	51%
Adjustment Agreed	159	45%
Adjustment Unagreed/Other	15	4%
<b>Total Closed</b>	<b>356</b>	<b>100%</b>

Even among those whose returns were adjusted, the average adjustment was only \$810 per return.<sup>35</sup> However, the IRS discouraged many taxpayers (including benign actors) from applying to the streamlined program, for example, if they had an understatement of more than \$1,500 or other “risk factors.”<sup>36</sup>

In addition, the IRS narrowly construed the exceptions under which taxpayers could receive lower rates within the OVD programs. Fewer than two percent of the offshore penalties assessed against OVD applicants were assessed at these reduced offshore penalty rates, as shown on the figure below.

**FIGURE 1.7.3, Total OVD offshore penalty assessments by rate<sup>37</sup>**

Offshore Penalty Rate	Total (millions)	Percent
Regular Rate (20%, 25%, or 27.5%)	\$4,143	98.4%
Reduced Rate (5% or 12.5%)	\$58	1.4%
Other	\$7	0.2%
<b>Total</b>	<b>\$4,208</b>	<b>100.0%</b>

The only other option for benign actors was to opt out of the OVD programs and be examined. However, because those opting out faced prolonged uncertainty, the expense and stress of an examination, potential appeals, and the risk of even more severe penalties, some agreed to pay the (offshore) penalty designed for bad actors, as described in prior reports.<sup>38</sup>

### **IRS data indicate that benign actors paid a proportionately greater offshore penalty than bad actors.**

People who are unrepresented or who have small accounts are perhaps more likely to make inadvertent reporting violations than those who are represented or have large accounts. Those with small accounts generally had less to gain from failing to disclose them and fewer resources to investigate the reporting requirements. Similarly, those without representation were probably less likely to know about the requirement.

34 IRS response to TAS information request (July 30, 2014).

35 IRS response to TAS information request (Dec. 2, 2014).

36 See Form 14438, *Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer* (Aug. 2013).

37 IRS response to TAS information request (July 30, 2014) (analysis of data from OVD closed case reports for the 2009, 2011, and 2012 programs).

38 See, e.g., OVD Reports.

Under the 2009 OVD program, however, the median offshore penalty paid by those with the smallest accounts was nearly six times the median unreported tax, as compared to about three times the unreported tax for those with the largest accounts, as shown on the figure below. Moreover, unrepresented taxpayers paid proportionately more regardless of the size of their accounts, as shown below.

**FIGURE 1.7.4, Comparison of median offshore penalties to unpaid tax by median account size and representation for the 2009 OVD program<sup>39</sup>**

	Bottom 10%	Middle 80%	Top 10%
Offshore account(s) balance	\$44,855	\$607,875	\$7,259,580
2009 OVD penalty	\$8,540	\$117,803	\$1,410,517
Additional tax, tax years 2002–2011	\$1,472	\$30,894	\$452,966
Offshore penalty as a percent of tax assessed	580%	381%	311%
Unrepresented percent	31%	11%	4%
Offshore penalty as a percent of tax assessed (unrepresented taxpayers only)	772%	474%	398%

Under the 2011 OVD program, the median offshore penalty for those with the smallest accounts rose to eight times the unreported tax, up from about six times the unreported tax under the 2009 program, as shown above and below. Unrepresented taxpayers continued to pay proportionately more except for those with the smallest accounts, as shown on the figure below. Moreover, for the middle 80 percent of taxpayers, the offshore penalty percentage increased by about 85 percent between the 2009 and 2011 programs (from 381 to 706 percent) while the median account balance declined by about 70 percent (from \$607,875 to \$183,993). Thus, the offshore penalty became increasingly more disproportionate for those with small accounts who were most likely to have been benign actors.

<sup>39</sup> National Taxpayer Advocate 2013 Annual Report to Congress 228-238. All figures are medians rather than averages because the data contains extreme outliers. The 2009 OVD program data was not updated because it has not changed significantly since last year's report. For the purposes of this analysis (and the analysis in the table below), we consider unrepresented taxpayers to be those without a Transaction Code 960 present on the Compliance Data Warehouse Individual Master File Transaction History table as of October 3, 2013. If the IRS Master File database indicated that a taxpayer had a representative on any tax module for any of tax years 2003-2012, then the taxpayer was considered represented, even though he or she may have been unrepresented in connection with the OVD program.

**FIGURE 1.7.5, Comparison of median offshore penalties to unpaid tax by median account size and representation for the 2011 OVD program<sup>40</sup>**

	Bottom 10%	Middle 80%	Top 10%
Offshore account(s) balance	\$17,368	\$183,993	\$3,833,152
2011 OVD penalty	\$2,202	\$41,238	\$888,943
Additional tax, tax years 2003–2012	\$268	\$5,845	\$190,579
Offshore penalty as a percent of tax assessed	821%	706%	466%
Unrepresented percent	53%	30%	10%
Offshore penalty as a percent of tax assessed (unrepresented taxpayers only)	788%	736%	705%

Disproportionality may have increased between the 2009 and 2011 programs because those settling under the 2011 program generally had proportionately less unreported tax, but were still mostly subject to the “one-size-fits-all” offshore penalty, which rose from 20 percent in the 2009 program to 25 percent for 2011.

#### Taxpayers who opted out or were removed paid much less.

Taxpayers who had the courage to opt out or who were removed from the IRS’s OVD programs generally paid far smaller penalties. As shown on the following table, they were assessed less in penalties (including the FBAR penalty) than in additional taxes.

**FIGURE 1.7.6, Opt-out and removal examination results<sup>41</sup>**

Program	Returns Closed	Avg. Tax Assessed	Avg. FBAR Penalty <sup>42</sup>	Avg. Tax Penalty	Penalty to Tax Assessment Ratio
2009 OVD	1,865	\$13,667	\$2,288	\$10,633	95%
2011 OVD	1,381	\$3,974	\$794	\$930	43%
2012 OVD	34	\$178	\$0	\$31	17%
Canadian opt-out and streamlined	6,085	\$110	\$0	\$6	6%

40 Audit Information Management System Closed Case Database and the Individual Master File Transaction History (Aug. 29, 2014) (TAS analysis of closed case data where an offshore penalty was assessed inside the 2011 OVD program). Like those in the table above, all figures are medians. Although TAS pulled the 2009 OVD program data (above) based on directions from technical experts at the IRS, the IRS formally objected that the 2009 data “fails to capture taxpayers closed under old FAQ 35 where there was no additional tax assessment or taxpayers with offsetting adjustments.” IRS response to TAS information request (Dec. 6, 2013); IRS response to TAS information request (Dec. 2, 2014) (same). Accordingly, when TAS pulled the 2011 OVD program data it included taxpayers with no additional tax assessments or offsetting adjustments (as requested by the IRS), but the penalties were even more disproportionate, as shown above. All similar comparisons between the 2009 and 2011 program data in this report assume this difference in methodology does not materially affect the results.

41 IRS response to TAS information request (July 30, 2014). TAS received aggregate figures from the IRS and then divided them by the number of closed returns to compute averages. The penalty-to-tax assessment percentage is the sum of the average tax and FBAR penalties divided by the average tax assessment. The IRS recorded data on Canadians who opted out separately from other taxpayers. IRS response to TAS information request (July 30, 2014). It also combined streamlined examination results with the results of examinations of Canadians who opted out. *Id.*

42 By comparison, the average FBAR penalty assessed in the 4,584 examinations closed in 2011-2013 outside of the OVD programs was about \$40,685, with the IRS issuing warning letters in 791 (or about 17 percent) of them. IRS response to TAS information request (July 30, 2014). It also initiated about 95 criminal investigations and obtained 35 convictions during the 2011-2013 periods. *Id.*

For example, this figure shows that when taxpayers opted out of the 2011 OVD and were examined they only paid about \$5,698 on average (\$3,974 in tax, plus \$930 in tax penalties and \$794 in FBAR penalties), with penalties comprising only about \$1,724 of that amount. These results are not surprising. The IRS designed the opt-out process for those who felt the offshore penalty was too high—higher than the penalty that they would pay under the statute as enacted by Congress. The problem is that many benign actors did not opt out. Moreover, while the analysis above suggests that the penalties for benign actors have grown proportionately more severe inside the programs, they appear to have declined for those who opted out. As shown above, the penalty to tax percentage for those who opted out or were removed declined from 95 percent under the 2009 OVD program to 17 percent under the 2012 program.

### IRS delays may have prompted some benign actors to accept disproportionate offshore penalties.

The potential cost of representation in a lengthy examination and potential appeal, may have prompted some benign actors to pay a disproportionate offshore penalty. As shown on the following figure, OVD cases generally remained unresolved for long periods.

**FIGURE 1.7.7, OVD program applications, dispositions, and processing times as of September 30, 2014<sup>43</sup>**

	2009 OVDP		2011 OVDI		2012 OVDP	
	Number	Average Processing Days	Number	Average Processing Days	Number	Average Processing Days
Closed certifications	10,774	311.2	9,616	246.0	1,790	219.9
Closed opt-outs	264	566.7	500	195.5	34	308.6
Closed removals	88	620.4	576	482.4	0	0.0
<b>Total closed cases</b>	<b>11,126</b>	<b>318.9</b>	<b>10,692</b>	<b>240.0</b>	<b>1,824</b>	<b>221.2</b>
Open certifications	20	1,011.2	2,263	384.5	5,072	212.2
Open opt outs	0	0.0	135	437.7	26	377.6
Open removals	0	0.0	80	542.6	3	271.1
Open suspense	0	0.0	19	580.8	5	356.5
<b>Total open cases</b>	<b>20</b>	<b>1,011.2</b>	<b>2,497</b>	<b>396.0</b>	<b>5,106</b>	<b>214.7</b>
<b>TOTAL CASES</b>	<b>11,146</b>	<b>n/a</b>	<b>13,189</b>	<b>n/a</b>	<b>6,930</b>	<b>n/a</b>

Not everyone who feels comfortable making an OVD submission without representation also feels confident to represent themselves in a post-opt-out examination. Thus, the expected cost of such representation—costs that increase the longer the process—likely discouraged some benign actors from opting out.

### The IRS's one-sided interpretations of OVD FAQs likely prompted other benign actors to accept disproportionate offshore penalties.

Taxpayers who inadvertently violated the rules would be more likely to risk opting out and being examined by the IRS if they believed the IRS would treat them fairly and take only reasonable positions in any post-opt-out examination. Significant uncertainty about what constitutes a “willful” FBAR violation,

43 IRS response to TAS information request (Oct. 8, 2014). These figures do not include the time that taxpayers waited for the IRS's Criminal Investigation Division to clear them to participate or for the IRS to load their cases onto its tracking system.

what is required to establish “reasonable cause,” and the IRS’s wide latitude to determine the FBAR penalty amount increased the importance of how the IRS used its broad discretion in applying the rules.<sup>44</sup>

However, the IRS’s unreviewable, unpublished, and one-sided interpretations of certain OVD FAQs eroded confidence that the IRS would be reasonable in post-opt-out examinations. Stakeholders complained about the IRS’s strained interpretations of FAQs and recommended that the IRS adopt more formal guidance such as a revenue procedure.<sup>45</sup> One well-documented example, discussed in prior reports, is the IRS’s interpretation of 2009 OVDP FAQ 35.<sup>46</sup> In the context of the 2011 OVDI, the Taxpayer Advocate Service (TAS) continues to encounter other similarly strained interpretations on a regular basis. Although we were unable to obtain taxpayer consent to discuss even more egregious cases, the following example illustrates this ongoing problem.<sup>47</sup>

*Example:* An IRS employee took the position that a taxpayer’s foreign apartment must be included in the “offshore penalty” base solely because the taxpayer filed returns reporting income from the apartment between two and fifteen months late—after receipt of foreign information reporting documents relating to inherited property. The employee concluded the delay in filing returns meant that the apartment was related to tax noncompliance. Under the 2011 OVDI FAQ 35, “[t]he offshore penalty is intended to apply to all of the taxpayer’s offshore holdings that are related in any way to tax noncompliance.” FAQ 35 defines tax noncompliance as follows:

“Tax noncompliance includes failure to report income from the assets, as well as failure to pay U.S. tax that was due with respect to the funds used to acquire the asset.”

The taxpayer timely overpaid her taxes and reported the income from the apartment (albeit on late-filed returns), and the apartment was not acquired with untaxed funds. Thus, the IRS employee’s unreviewable determination to include the apartment in the offshore penalty base appears to contradict FAQ 35.

44 For further discussion of these issues, see, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 228-238.

45 See, e.g., Letter from New York State Bar Association Tax Section to Commissioner, IRS, Chief Counsel, IRS, and Acting Assistant Secretary (Tax Policy) Department of the Treasury, *2011 Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, reprinted as, *NYSBA Tax Section Comments on FAQ for 2011 Offshore Voluntary Disclosure Initiative*, 2011 TNT 153-13 (Aug. 9, 2011) (hereinafter “NYSBA Letter”) (identifying inconsistencies and recommending “FAQs be incorporated into some type of more permanent guidance such as a Revenue Procedure and that such guidance be subject to public comments.”); National Taxpayer Advocate 2013 Annual Report to Congress 228-238. Formal guidance could be interpreted by one branch of National Office of Chief Counsel attorneys whose advice could be published as Chief Counsel Advice (CCA), rather than by IRS technical advisors and SB/SE field attorneys. See, e.g., IRC § 6110.

46 See, e.g., OVD Reports; NYSBA Letter.

47 TAS has obtained taxpayer consent to discuss the case example described above. TAS developed its procedure for obtaining consents to publish case examples in consultation with the IRS Office of Chief Counsel. In response to a formal TAS request for the IRS to confirm whether the FAQ interpretations described in the example were correct—a request that also gave the IRS an opportunity to rectify the situation—the IRS stated:

“The IRS cannot confirm the allegations of employee interpretations as stated by TAS. Moreover it is not appropriate to discuss individual taxpayer cases as part of the Most Serious Problem process. There are separate processes for addressing individual taxpayer cases and the IRS works with TAS as appropriate through those processes. Finally, information being requested is information protected under IRC § 6103 and is not appropriate for a publicly released report.” IRS response to TAS information request (July 30, 2014).

The IRS Office of Chief Counsel has advised the National Taxpayer Advocate that the IRS was legally authorized to provide TAS with the requested information. Moreover, the IRS routinely provides TAS with information about individual taxpayer cases (e.g., as part of a case review or study) for the purpose of compiling this report.

Although the apartment would not be included in the penalty base outside of the OVD program, the taxpayer was unwilling to opt out. She feared that opting out could somehow affect her status as a green card holder or her application for U.S. citizenship.

When a taxpayer disagrees with a revenue agent's (*i.e.*, an auditor's) interpretation of an FAQ, the agent is not required to explain the interpretation or allow the taxpayer to speak with the technical advisor or counsel attorney whose advice he or she sought. Nor can the taxpayer have the interpretation reviewed by the IRS Office of Appeals. Moreover, these interpretations are unpublished. Thus, neither taxpayers nor the IRS can be sure revenue agents, technical advisors, or IRS attorneys are applying the FAQs consistently.

The IRS may, in fact, achieve consistency through frequent informal electronic and telephonic communications among IRS revenue agents, technical advisors, and attorneys. For example, IRS officials revealed at an ABA conference that some agents had attended web-based training and were using checklists concerning willfulness determinations. While these efforts should promote consistency, the materials were withheld from the public.<sup>48</sup> Without transparency as to these checklists and FAQ interpretations, neither taxpayers nor other IRS employees (including TAS employees and IRS executives) can be sure the IRS is treating taxpayers consistently.<sup>49</sup> Nor can they be confident IRS employees are consistently interpreting willfulness and reasonable cause *correctly*.

The IRS's seemingly arbitrary and one-sided approach to interpreting the OVD FAQs—interpretations that the IRS did not publish, explain, or subject to an appeal—eroded confidence that the IRS would be reasonable in post-opt-out examinations, prompting some benign actors to agree to pay disproportionate offshore penalties.

### Recent OVD program changes treat certain benign actors more reasonably.

On June 18, 2014 the IRS adopted some of the National Taxpayer Advocate's OVD-related recommendations. It modified the terms of the 2012 OVD program (called the 2014 OVDP) and created a new 2014 "streamlined" program that allows those who failed to file an FBAR and report offshore income to pay a reduced offshore penalty—five percent for U.S. residents and zero percent for nonresidents—if they certify that their violations were not willful.<sup>50</sup> At five percent of the offshore account balance, the penalty

48 Kristen A. Parillo, *ABA Meeting: More Guidance Coming On Modified OVDP and Streamlined Filing*, 2014 TNT 184-7 (Sept. 23, 2014). For a broader discussion of the IRS's difficulty with the Freedom of Information Act (FOIA), see for example, National Taxpayer Advocate 2011 Annual Report to Congress 380-403 (Most Serious Problem: *The IRS's Failure to Consistently Vet and Disclose its Procedures Harms Taxpayers, Deprives It of Valuable Comments, and Violates the Law*); National Taxpayer Advocate 2006 Annual Report to Congress 10-30 (Most Serious Problem: *Transparency of the IRS*); National Taxpayer Advocate 2008 Objectives Report to Congress xxi-xxvii (*Update on Transparency of the IRS*); and National Taxpayer Advocate 2010 Annual Report to Congress 71-84 (Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review*).

49 TAS gave IRS management an opportunity to comment on whether it believes the FAQs were applied consistently and correctly in a handful of cases TAS had worked where revenue agents either disregarded the FAQs completely or gave them strained anti-taxpayer interpretations, including the example above. As noted above, IRS management said it "cannot confirm the allegations of employee interpretations." IRS response to TAS information request (July 30, 2014). While also asserting that providing such information would not be "appropriate," the response suggests at least tacit management support for the anti-taxpayer interpretations about which we have raised concerns.

50 To qualify for the nonresident streamlined program, a person must have been a nonresident in one of the last three years for which a return was required. IRS, *U.S. Taxpayers Residing Outside the United States* (Oct. 9, 2014). However, the program defines "nonresident" very narrowly—generally excluding people if they or their spouses have visited the U.S. for vacation, to work, to visit a sick relative, or to shop on more than 35 days. IRS, *U.S. Taxpayers Residing Outside the United States* (Oct. 9, 2014); IRS, *U.S. Taxpayers Residing in the United States* (Oct. 9, 2014). TAS commented that the IRS should use a more expansive definition of nonresident.

is less harsh than the 27.5 percent (or 50 percent) penalty under the 2012 or 2014 OVDP.<sup>51</sup> Because taxpayers are not offered a closing agreement under the 2014 program, however, the IRS could examine them and assess higher penalties. Thus, benign actors in the streamlined program do not have the same right to finality as bad actors in the other OVD programs.<sup>52</sup>

During a transition period, taxpayers with open OVD program cases, who had not signed closing agreements, could also participate in the streamlined program and receive a closing agreement if the IRS agreed their violations were not willful.<sup>53</sup> The last time the IRS created more favorable rates for certain types of benign actors—the 5 and 12.5 percent rates (described above)—it allowed qualifying taxpayers who already had signed closing agreements to amend them so they were not disadvantaged by having come forward earlier.<sup>54</sup> For the 2014 program changes, however, the IRS did not offer the same terms to benign actors who already had signed (and countersigned) closing agreements. Thus, the 2014 OVD-related changes represent a major step forward in distinguishing between benign actors and bad actors, as contemplated by Congress, but they leave many benign actors with previously signed closing agreements feeling punished for having come forward early.

### The OVD program guidance-making and disclosure process remains flawed.

The IRS still has not adopted the National Taxpayer Advocate's recommendations to improve transparency or accountability in its program guidance or FAQ interpretations. Although it may receive OVD-related comments from TAS and the public, it has not formally asked for comments from internal or external stakeholders, and does not necessarily address the comments it receives to explain why it has adopted some and not others.<sup>55</sup> Nor does it disclose all of the guidance that employees are applying (*e.g.*, the FAQ interpretations described above). Thus, the OVD-related guidance-making process remains flawed. As a result, the IRS will continue to be viewed as ignoring reasonable concerns and some OVD

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- 51 As of the end of FY 2014, there were approximately 3,085 applicants to the new 2014 streamlined program and 1,409 applicants to the 2014 OVDP. IRS response to TAS information request (Dec. 2, 2014). As of October 8, 2014, no results had been captured for either program. *Id.*
- 52 See IRS Pub. 1, *Your Rights as a Taxpayer* (2014) (announcing the IRS's intention to give taxpayers the right to finality). Only taxpayers with open OVD program cases were permitted to obtain closing agreements under the 2014 streamlined program terms. IRS, *Transition Rules: Frequently Asked Questions (FAQs)* (June 18, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Transition-Rules-Frequently-Asked-Questions-FAQs>.
- 53 Streamlined Filing Compliance Procedures (June 18, 2014), <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures>. (“A taxpayer eligible for treatment under the streamlined procedures who submits, or has submitted, a voluntary disclosure letter under the OVDP (or any predecessor offshore voluntary disclosure program) prior to July 1, 2014, but who does not yet have a fully executed OVDP closing agreement, may request treatment under the applicable penalty terms available under the streamlined procedures.”)
- 54 See 2011 OVDI FAQ #52 (“Taxpayers who participated in the 2009 OVDP whose cases have been resolved and closed with a Form 906 closing agreement who believe the facts of their case qualify them for the 5% reduced penalty criteria of the 2011 OVDI, but paid a higher penalty amount under the 2009 OVDP should provide a statement to this effect ... Upon receipt of this information, the case will be assigned to an examiner to review and make a determination.”); 2011 OVDI FAQ #53 (same).
- 55 Although the Large Business and International (LB&I) division does not ask for public comments before issuing OVD-related guidance, it has begun asking a member of the National Taxpayer Advocate's staff to comment on such guidance on short notice. TAS appreciates this opportunity to comment. However, LB&I has not asked for TAS or other affected IRS functions for comments using the normal Internal Management Document (IMD) process for clearing and disclosing interim guidance to staff or IRM changes. IRM 1.11.1 (Sept. 4, 2009); IRM 1.11.9 (Apr. 7, 2014). The IMD process contains procedures for dispute resolution. *Id.* Thus, LB&I has not explained why it has not adopted some of TAS's comments. Nor has LB&I asked for comments from the IRS Office of Servicewide Penalties (OSP)—the IRS office supposedly charged with “coordinating policy and procedures concerning the administration of penalty programs.” IRM 20.1.6.1.1 (Sept. 17, 2010); IRM 4.24.9.1 (Oct. 26, 2012) (same); OSP response to TAS information request (July 10, 2014) (indicating that LB&I had merely asked OSP for new penalty reference numbers in connection OVD-related program changes). For a more detailed discussion of this problem see, Most Serious Problem: *PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote Voluntary Compliance, as Recommended by Congress and Others, infra.*

participants will continue to believe the IRS is not applying the FAQs consistently or fairly. This state of affairs does not engender trust in IRS policies, procedures, or actions.

## CONCLUSION

OVD program data suggest that the IRS turned the statutory scheme on its head by charging benign actors the same offshore penalty as bad actors. Further, the pressure benign actors felt to accept the OVD program terms rather than opting out, eroded taxpayer rights, such as the *rights to pay no more than the correct amount of tax, challenge the IRS's position and be heard, appeal an IRS decision in an independent forum, and to a fair and just tax system*.<sup>56</sup>

Recent changes to the OVD programs address some of TAS's concerns. However, unlike the last time the IRS made taxpayer-favorable changes to an OVD program, the IRS will not allow those who already agreed to pay disproportionate offshore penalties to benefit from the most recent changes.

Moreover, the IRS still does not formally ask for internal or external comments before issuing OVD guidance, or publicly explain why it has adopted some comments and not others. Nor does it disclose its interpretations of FAQs or other internal guidance to the public. Correcting these flaws would further the taxpayer *right to be informed*.<sup>57</sup>

The flaws in the OVD programs, outlined in this report, do not bode well for fairness and justice in the IRS's implementation of future settlement programs where taxpayers have diverse facts and circumstances. Moreover, the IRS's unwillingness to address these flaws and fundamentally restructure its offshore initiatives undermines voluntary compliance and places taxpayers at risk of disproportionate penalties.

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<sup>56</sup> See IRS Pub. 1, *Your Rights as a Taxpayer* (2014).

<sup>57</sup> *Id.*

## RECOMMENDATIONS

In the interests of effective tax administration, the National Taxpayer Advocate recommends the IRS:

1. Improve the transparency of the OVD and streamlined programs by:
  - a. Publishing OVD-related program guidance as a revenue procedure (or similar guidance published in the Internal Revenue Bulletin) that incorporates comments from internal and external stakeholders, and assigning interpretation of the guidance to national office attorneys whose advice would be disclosed to the public just like other Chief Counsel Advice (CCA).
  - b. Providing instructions to OVD program staff by incorporating them into the IRM, which incorporates comments from internal stakeholders and is disclosed to the public.
  - c. Publishing interpretations of the program terms by any IRS employees authorized to interpret them (*e.g.*, by IRS attorneys and technical advisors) just like CCA.
  - d. More frequently updating the guidance on the IRS website with any clarifying interpretations rendered by technical advisors or other IRS employees to the extent those interpretations are not incorporated into other public guidance.<sup>58</sup>
2. Allow taxpayers to elevate or appeal a revenue agent's OVD and streamlined program determinations. At a minimum, the agent and anyone who advised him or her (*e.g.*, a technical advisor or IRS attorney) with respect to a disputed assumption should be required to explain his or her reasoning to the taxpayer in writing and reconsider the advice in light of any new facts or analysis provided by the taxpayer.
3. Allow taxpayers to amend their closing agreements to benefit from recent OVD-related program changes.<sup>59</sup>

<sup>58</sup> Rather than changing the FAQs each time, a list of all clarifying guidance applicable to a specific FAQ could be made visible if a user clicked on that particular FAQ.

<sup>59</sup> The IRS previously offered to amend 2009 OVDP agreements for taxpayers who would qualify for the reduced 5 percent or 12.5 percent offshore penalty rates under the 2011 OVDI. See 2011 OVDI FAQ #52; 2011 OVDI FAQ #53.

MSP  
# 8**PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote Voluntary Compliance, as Recommended by Congress and Others****RESPONSIBLE OFFICIALS**

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**DEFINITION OF PROBLEM**

Over 20 years ago, Congress recommended the IRS “develop better information concerning the administration and effects of penalties” to ensure they promote voluntary tax compliance.<sup>1</sup> It is the IRS’s official policy to do so,<sup>2</sup> and many of the IRS’s stakeholders, including the National Taxpayer Advocate, have recommended that the IRS do more in this area.

The IRS has assigned responsibility for IRS-wide penalty policy to the Office of Servicewide Penalties (OSP). As the number of civil penalties has increased—from 14 in 1955 to more than 170 today—this responsibility has become more difficult.<sup>3</sup> However, OSP has not been given the resources to conduct (or review) penalty research on a regular basis and has ignored TAS’s penalty research. OSP, an office buried at least three levels below the Small Business/Self-Employed (SB/SE) division Commissioner, cites insufficient resources, insufficient staffing, employees with the wrong skillsets, and a lack of access to penalty-related data as barriers to conducting such research.<sup>4</sup> It also appears to lack the authority to implement any significant IRS-wide changes to penalty administration. Other IRS business units do not ask OSP for substantive comments before they implement major penalty initiatives or policy changes. Moreover, the IRS has not developed a plan to address the challenges faced by OSP, as it committed to do in 2009.<sup>5</sup> As a result, some of the IRS’s penalty procedures are more likely to discourage than encourage voluntary compliance.<sup>6</sup>

- 1 See, e.g., H.R. REP. NO. 101-386, at 661 (1989) (Conf. Rep).
- 2 Policy Statement 20-1 (Formerly P-1-18), *reprinted at* IRM 1.2.20.1.1(1)-(2) (June 29, 2004).
- 3 IRM 20.1.1.1.1 (Nov. 25, 2011) (14 civil penalties in 1955); IRS response to TAS information request (July 10, 2014) (stating OSP is charged with “administering more than 170 different civil penalties”). The IRS only assessed 151 different penalties in fiscal year (FY) 2013). TAS research data from the Enforcement Revenue Information System (ERIS) on the Compliance Data Warehouse (CDW) (Oct. 8, 2014) (reflecting assessments of 151 different penalties—67 for individuals and 84 for businesses—for FY 2013).
- 4 IRS response to TAS information request (July 10, 2014); IRS Human Resources Reporting Center (HRRC), Servicewide Penalties Organizational Chart (Sept. 20, 2014).
- 5 Government Accountability Office (GAO), GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009) (IRS response).
- 6 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*). For a discussion of various problems with penalty procedures see, e.g., National Taxpayer Advocate 2007 Annual Report to Congress 275 (Most Serious Problem: *The Accuracy-Related Penalty in the Automated Underreporter Units*); National Taxpayer Advocate 2013 Annual Report to Congress 103 (Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers From Claiming EITC*); National Taxpayer Advocate 2013 Annual Report to Congress 228 (Most Serious Problem: *The IRS Offshore Voluntary Disclosure Program Disproportionately Burdens Those Who Made Honest Mistakes*).

## ANALYSIS OF PROBLEM

### The IRS is Supposed to Ensure that its Penalty Policy Promotes Voluntary Compliance.

The last comprehensive reform of the Internal Revenue Code's (IRC's) penalty provisions was enacted in 1989, after careful study by Congress, the IRS, and other stakeholders.<sup>7</sup> As part of these reforms, Congress recommended that the IRS “develop better information concerning the administration and effects of penalties” to ensure penalty provisions and the IRS's administration of them promote voluntary compliance.<sup>8</sup> In a hearing leading up to the 1989 legislation, Senator Pryor explained that:

[t]he IRS places a low priority on collecting data necessary in the administration of those [sic] penalties. To use an analogy, I would find it very difficult to believe that a major U.S. company would manage a comparable program so vital to its business mission without essential data collection to analyze the success and failure of the program.<sup>9</sup>

The IRS adopted a policy statement consistent with Congress's recommendation. It states that:

- “The Office of Penalty and Interest Administration [a predecessor of OSP] must review and approve changes to the Penalty Handbook for consistency with Service Policy before making recommended changes.”
- “The Service collects statistical and demographic information to evaluate penalties and penalty administration, and to determine the effectiveness of penalties in promoting voluntary compliance.”
- “The Service continually evaluates the impact of the penalty program on compliance and recommends changes when the Internal Revenue Code or penalty administration does not effectively promote voluntary compliance.”<sup>10</sup>

More recently, the National Taxpayer Advocate, the Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), the American Bar Association (ABA) Tax Section, and the American Institute of Certified Public Accountants (AICPA) have all recommended that the IRS collect more data on penalties and do more to analyze their effect on voluntary compliance.<sup>11</sup> Penalty analysis is increasingly difficult because the number of civil penalties the IRS administers has increased from 14 in 1955 to more than 170 today.<sup>12</sup> The IRS assessed about 37.9 million (or \$25.9 billion in aggregate) civil penalties in FY 2013, up from about 15 million (or \$1.3 billion in aggregate) in FY 1978 (the earliest year available).<sup>13</sup> It also abated about 4.9 million civil penalties (or \$11.5 billion in aggregate) in FY 2013, up from 1.4 million (or \$338 million in aggregate) in FY 1978.<sup>14</sup>

7 See, e.g., Executive Task Force for Internal Revenue Commissioner's Penalty Study, *A Philosophy of Civil Tax Penalties* (Discussion Draft), reprinted in 111 DTR L-1 1988, 9-10 (June 9, 1988); H.R. REP. NO. 101-386 at 661 (1989) (Conf. Rep.).

8 H.R. REP. NO. 101-386 at 661 (1989) (Conf. Rep.) (also stating that, in connection with civil tax penalty reform, “the IRS should develop a policy statement emphasizing that civil tax penalties exist for the purpose of encouraging voluntary compliance”).

9 *Hearing Before the Comm. on Finance, Subcomm. on Private Retirement Plans and Oversight of the Internal Revenue Service*, 100th Cong. 2d Sess. 2 (Sept. 28, 1988) (Opening Statement of Sen. David Pryor).

10 Policy Statement 20-1 (Formerly P-1-18), reprinted at IRM 1.2.20.1.1(11)-(12) (June 29, 2004).

11 See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*); GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009); TIGTA, Ref. No. 2001-40-069, *Ineffective Administration of the Individual Taxpayer Penalty Program Creates Inequity* 9 (Apr. 2001); ABA Section of Taxation, *Statement of Policy Favoring Reform of Federal Civil Tax Penalties* 13 (Apr. 21, 2009); Am. Inst. of Certified Pub. Accountants, *Report on Civil Tax Penalties: The Need for Reform* 16 (Aug. 28, 2009).

12 IRM 20.1.1.1.1 (Nov. 25, 2011); IRS response to TAS information request (July 10, 2014).

13 IRS Data Book (FY 2013) (Table 17); IRS Data Book (FY 1978) (Table 13).

14 *Id.*

### The IRS Does Not Regularly Study the Effect of Penalties on Voluntary Compliance.

The IRS has assigned responsibility for “reviewing and analyzing penalty information, researching penalty effectiveness on compliance trends, and determining appropriate action necessary to promote voluntary compliance” to OSP.<sup>15</sup> Over 20 years after Congress’s recommendation and at least five years after the IRS’s stakeholders (identified above) recommended the IRS do more to study the effect of penalties on voluntary compliance—or at least develop a plan to do so—the OSP has neither produced nor reviewed much research regarding the extent to which penalties promote voluntary compliance (or noncompliance).

Since 2004, the OSP has reviewed only one inconclusive study concerning the effect of three penalties on voluntary compliance.<sup>16</sup> The study did not prompt any policy changes. According to the IRS, it does not do more penalty research because:

[OSP does not have] sufficient resources with the specialized knowledge and skill sets nor access to all the various databases which could assist in civil penalty research and analysis ... the IRS functions OSP relies on to compile such data do not have specialized knowledge to apply all of the intricacies and nuances associated with civil penalty assessments and abatements ... [and] The separation of different specialized knowledge between two different IRS offices often results in misinterpretations of the type and extent of analyses needed for civil penalties. In addition, the massive amount of data needed to analyze behavior over multiple years as well as the numerous variables to be analyzed each year in order to fully determine a penalty’s impact on voluntary compliance is a barrier to effective data analysis.<sup>17</sup>

Despite this acknowledged lack of expertise and resources, since 2008 OSP has not obtained any new authority, resources, staffing, data/information, systems, or training, and its staff has diminished to six analysts.<sup>18</sup> Further, OSP is buried in the IRS bureaucracy, reporting to the SB/SE Director of Examination Policy, a position three levels below the SB/SE Commissioner.<sup>19</sup> The net effect of this situation is that the IRS has abdicated its responsibility to conduct effective penalty administration, as it continues to apply penalties without regard to whether its penalty-related policies further voluntary compliance.

15 IRM 20.1.1.1.3 (Dec. 11, 2009). See also IRM 20.1.6.1.1 (Sept. 17, 2010) (“Overall responsibility for the penalty programs is assigned to OSP ... OSP is charged with coordinating policy and procedures concerning the administration of penalty programs and ensuring consistency with the penalty policy statement”); IRM 4.24.9.1 (Oct. 26, 2012) (same).

16 In response to a TAS request to “provide any research OSP has conducted, requested, or reviewed and considered in evaluating penalty policy changes since ... 2004,” the IRS identified inconclusive research completed in 2011 by SB/SE research concerning the effect of the first time abatement (FTA) program on future compliance by business taxpayers. IRS response to TAS information request (July 10, 2014). It also identified a request for SB/SE Research to participate as facilitator for the Civil Penalties Administration Improvement Team (CPAIT), to assist “OSP with the Force Field Analysis results obtained during the Civil Penalties Forums in 2011,” and to study the subsequent compliance of the taxpayers that received FTF, FTP, or FTD penalties. *Id.* However, this last study “did not meet the stated objectives because Exam Policy sought a dedicated database” and is currently being conducted by the IRS Research Analysis and Statistics (RAS) function. *Id.* The IRS’s response also suggests that OSP does not contract with external researchers or review penalty research conducted by them.

17 IRS response to TAS information request (July 10, 2014).

18 *Id.* IRS HRRC, *Service-wide Penalties on Rolls List* (Sept. 20, 2014).

19 IRS HRRC, *Service-wide Penalties, Organization Chart* (Sept. 20, 2014).

### OSP Does Not Regularly Make or Recommend Changes to Enhance Voluntary Compliance, as Contemplated by the Policy Statement.

In response to a TAS request, OSP did not identify any significant changes to IRS-wide penalty policy that it had implemented to enhance voluntary compliance in the last ten years.<sup>20</sup> In 2009, OSP recommended that the penalty under IRC § 6657 for bad checks be extended to various types of electronic payments.<sup>21</sup> However, it has not offered any other legislative recommendations.

Since 2004, the Office of Servicewide Penalties has reviewed only one inconclusive study concerning the effect of three penalties on voluntary compliance.

### The IRS Has Not Implemented TAS's Research-Based Penalty Policy Recommendations to Improve Voluntary Compliance.

TAS recently completed a number of penalty-related studies and analyses about the appropriate use of penalties. A 2008 TAS study identified areas where penalty administration deviated from core principles articulated in 1989, potentially discouraging voluntary compliance.<sup>22</sup> Between 2011 and 2013, TAS repeatedly analyzed the effect of the IRS's disproportionate "offshore penalty" on voluntary compliance and suggested reforms that could help it better promote voluntary compliance.<sup>23</sup> A 2013 TAS study analyzed the effect of accuracy-related penalties on voluntary compliance.<sup>24</sup> Although these studies identified administrative changes that could improve voluntary compliance, with the exception of some recent recommendations relating to the "offshore penalty," the IRS has not adopted them.<sup>25</sup>

### *The IRS Still Imposes Penalties Automatically—Before Determining if They Actually Apply.*

A 2008 TAS study discussed the IRS's policy of automatically proposing the negligence penalty when the IRS finds a mismatch between the taxpayer's return and an information return in two or more years, and the taxpayer does not respond to the IRS's form letter by satisfactorily explaining the apparent discrepancy.<sup>26</sup> In such cases the IRS is not required to make an outgoing call (unless the taxpayer responds to the letter) to determine if the taxpayer was actually negligent or had reasonable cause.<sup>27</sup> The study observed

20 IRS response to TAS information request (July 10, 2014) (describing, instead, challenges from implementing newly enacted legislation, updating and maintaining IRMs, various forms, publications, letters, and notices, and from responding to executive requests, congressional inquiries, TIGTA investigations, and GAO reports).

21 *Id.*

22 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*); National Taxpayer Advocate 2008 Annual Report to Congress 414 (Legislative Recommendation: *Reforming the Penalty Regime*).

23 See, e.g., National Taxpayer Advocate 2015 Objectives Report to Congress; National Taxpayer Advocate 2013 Annual Report to Congress 223; National Taxpayer Advocate 2012 Annual Report to Congress 134-53; National Taxpayer Advocate 2011 Annual Report to Congress 191-205; *Id.* at 206-72; National Taxpayer Advocate 2013 Objectives Report to Congress 7-8; *Id.* at 21-29 [collectively the *OVD Reports*].

24 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*). The 2013 study built on a 2012 TAS study which suggests trust for the IRS may promote voluntary compliance more strongly than deterrence—the possibility that the IRS will detect and penalize tax cheating—findings with significant implications for penalty administration. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 13 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

25 For a discussion of the OVD programs, see, e.g., the *OVD Reports*.

26 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*). See also National Taxpayer Advocate 2007 Annual Report to Congress 275 (Most Serious Problem: *The Accuracy-Related Penalty in the Automated Underreporter Units*).

27 Exam generally sends Letter 566 to ask for documentation before sending Letter 525 to propose a deficiency and penalty. IRM 4.19.10.4.10.1, *Initial Contact Letter (ICL) Procedures* (Jan. 1, 2013). However, even Exam will only try to call the taxpayer if it receives a response. See IRM 4.19.13.11, *No Response and Unagreed Cases* (Jan. 1, 2013).

that many stakeholders object to such automated penalty procedures,<sup>28</sup> which seem to violate direction from Congress to “make a correct substantive decision in the first instance rather than mechanically assert penalties with the idea that they will be corrected later.”<sup>29</sup> The policy also ignored concerns expressed in a House Budget Committee report:

[t]hat the present-law accuracy-related penalties (particularly the penalty for substantial understatements of tax liability) have been determined too routinely and automatically by the IRS. The committee expects that enactment of standardized [reasonable cause] exception criterion will lead the IRS to consider fully whether imposition of these penalties is appropriate **before** determining these penalties (emphasis added).<sup>30</sup>

TAS recommended the IRS discontinue its practice of assessing accuracy-related penalties for negligence before actually determining whether the taxpayer was negligent.<sup>31</sup> Rather than *reconsidering* its automated approach to penalties, the IRS *extended* it to the penalty for improperly claiming credits.<sup>32</sup>

A 2013 TAS study suggested that accuracy-related penalties do not improve reporting compliance among taxpayers subject to default assessments, such as those resulting from automated programs, and five years later these taxpayers appeared *less* compliant than those not subject to penalties.<sup>33</sup> The IRS has neither disputed the findings of this study—that such automated penalty assessments policies undermine long-term voluntary compliance—nor agreed to change its policies.

### *The IRS’s Offshore Voluntary Disclosure (OVD) Programs Extracted Disproportionate Penalties From Unrepresented Taxpayers Trying to Correct Inadvertent Errors.*

Another core principle identified in 1989 as consistent with voluntary compliance—as well as the research discussed above—is that penalties should be perceived as proportionate. However, the IRS’s policies create the perception that it is using its broad discretion in applying penalties for failure to file information returns—such as the penalties for failure to file Forms 3520, 3520-A, 5471, 5472, 926, 8865, 8938, or a Foreign Bank Account Report (FBAR)—to extract seemingly arbitrary and disproportionate “offshore penalties” in connection with its Offshore Voluntary Disclosure (OVD) settlement programs.<sup>34</sup> Moreover, these programs penalized unrepresented taxpayers with small unreported accounts—those most likely to

28 Am. Inst. of Certified Pub. Accountants, *Report on Civil Tax Penalties: The Need for Reform* (Aug. 28, 2009); ABA Tax Section, *Comments Concerning Possible Changes to Penalty Provisions of the Internal Revenue Code* (1999).

29 H.R. Rep. No. 101-386, at 661 (1989) (Conf. Rep.). See also IRC § 6751(b)(1) (generally requiring penalties to be personally approved by a supervisor before assessment unless automatically calculated through electronic means).

30 H.R. Rep. No. 101-247 at 2863 (1989) (Budget Comm. Rep.).

31 See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, § 1 (*A Framework for Reforming the Penalty Regime*).

32 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 182 (Most Serious Problem: *The IRS Assessed Penalties Improperly, Refused to Abate them, and Still Assesses Penalties Automatically*) (discussing IRS’s use of the accuracy-related penalties for credit claims); National Taxpayer Advocate 2013 Annual Report to Congress 108 (Most Serious Problem: *The IRS Inappropriately Bans Many Taxpayers from Claiming EITC*) (discussing the “penalty” for improperly claiming the Earned Income Tax Credit (EITC) (*i.e.*, the two-year ban)); National Taxpayer Advocate 2013 Annual Report to Congress 311 (Legislative Recommendation: *Allocate to the IRS the Burden of Proving It Properly Imposed the Two-Year Ban on Claiming the Earned Income Tax Credit*). The IRS views the EITC two-year ban as a procedural rule, rather than a penalty. IRS response to TAS information request (July 10, 2014). Regardless of its characterization, the rule penalizes taxpayers, and, if it creates the impression the IRS is unfair, it likely affects voluntary compliance.

33 See National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, § 1 (Study: *Do Accuracy-Related Penalties Improve Future Reporting Compliance by Schedule C Filers?*).

34 See, e.g., *OVD Reports*.

have made inadvertent or unintentional mistakes that they were trying to correct—more severely than criminal tax evaders with large accounts.<sup>35</sup>

To make matters worse, the IRS’s computation of the offshore penalty, which is often counterintuitive, is not subject to appeal or adequate explanation. The IRS does not publish its interpretations of the frequently asked questions (FAQs) describing how the offshore penalty is computed and taxpayers are not entitled to speak to the IRS employee (*e.g.*, a technical advisor or attorney) who decided how to compute it. This lack of transparency and due process in connection with the offshore penalty computation is perceived as unfair and violates the spirit, if not the letter, of the IRS’s penalty policy statement, which states:

[T]he Service will demonstrate the fairness of the tax system to all taxpayers by: Providing every taxpayer against whom the Service proposes to assess penalties with a reasonable opportunity to provide evidence that the penalty should not apply; Giving full and fair consideration to evidence in favor of not imposing the penalty, even after the Service’s initial consideration supports imposition of a penalty ...<sup>36</sup>

Moreover, the perceived unfairness, and lack of transparency and due process in the OVD programs violates the IRS’s recently-adopted Taxpayer Bill of Rights. Those rights include *the right to be informed, the right to challenge the IRS’s position and be heard, the right to appeal an IRS decision in an independent forum, and the right to a fair and just tax system.*<sup>37</sup>

### The IRS Has Resisted Research-Driven Recommendations to Improve the Effect of Penalties on Voluntary Compliance.

As noted above, OSP has not reviewed TAS’s studies or other studies conducted by outside researchers or academics. Moreover, OSP appears to disagree with direction from Congress to “make a correct substantive decision in the first instance rather than mechanically assert penalties with the idea that they will be corrected later,”<sup>38</sup> because it “does not consider it unfair to taxpayers for the IRS to assert penalties through a systemic process which applies distinct criteria to identify **potential** instances of noncompliance ...” (emphasis added).<sup>39</sup>

Further, OSP responded to TAS’s suggestion that the IRS stop automating various penalty assessments by stating that it had no authority to change those procedures even though they were described in the Penalty Handbook, which it is responsible for updating.<sup>40</sup> According to OSP, any change in penalty policy requires a collaborative decision between OSP, IRS Counsel, and the business operating divisions impacted by such change.<sup>41</sup> However, other IRS business units do not ask OSP for substantive comments before they implement major penalty policy changes or initiatives. For example, other business units did not ask OSP for substantive comments before implementing the 2009, 2011, 2012 or 2014 OVD programs or before automating the assertion of penalties for failure to file Form 5471 in 2009 or Form 5472

35 See *id.* These policies are also inconsistent with Congress’ direction in 1989. See H.R. REP. No. 101–247 at 1405 (Budget Committee) (“The IRS should better use its limited enforcement resources to ensure that taxpayers who continually fail to comply with the reporting requirements are identified and penalized, rather than focusing only on taxpayers who are working with the IRS in an attempt to comply with the law.”).

36 IRS Policy Statement 20-1 (Formerly P-1-18), *reprinted* as IRM 1.2.20.1.1 (June 29, 2004).

37 IRS, Pub. 1, *Your Rights as a Taxpayer* (Rev. 6-2014).

38 H.R. REP. No. 101-386, at 661 (1989) (Conf. Rep.). See also H.R. REP. No. 101-247 at 2863 (1989) (Budget Comm. Rep.).

39 IRS response to TAS information request (July 10, 2014).

40 *Id.* Meeting with OSP executives (Mar. 21, 2014).

41 *Id.*

in 2013.<sup>42</sup> The result of this lack of communication and splintered responsibility is an ineffective penalty regime that harms taxpayers and does not foster voluntary compliance.

### The IRS Still Has No Plan to Evaluate Penalty Administration or the Effect of Penalties on Voluntary Compliance.

In response to a 2009 GAO report, the IRS agreed that OSP would develop a plan to evaluate penalty administration and the impact of penalties on voluntary compliance.<sup>43</sup> Recognizing that this plan should incorporate comments from internal and external stakeholders, the IRS conducted two civil tax penalty forums in June 2011 and formed a Civil Penalties Administration Improvement Team (CPAIT).<sup>44</sup> However, the IRS put development of the plan on hold due to budgetary constraints.<sup>45</sup> The draft plan has not been finalized, approved, or provided to GAO or TAS.<sup>46</sup>

## CONCLUSION

The IRS and its stakeholders, including Congress, all agree that the IRS should use data and research to ensure that penalties promote voluntary compliance, and change IRS procedures or make recommendations for legislative change when they do not. However, the IRS has delegated this responsibility to OSP and declined to provide it with the resources necessary to do so. OSP's staff of six employees does not conduct penalty research. They assert they do not have the skills or access to data they would need to conduct such research. They also face barriers in obtaining assistance from IRS research functions. Moreover, OSP does not review private-sector research or act on TAS's penalty research. OSP apparently has not been given authority to do so. In addition, the IRS still does not have a plan to evaluate penalty administration and the impact of penalties on voluntary compliance.

It will be difficult for the IRS (or OSP) to evaluate the effect of penalties if it ignores prior research. It would be easier for the IRS to evaluate their effects in light of the research and conclusions already reached by the IRS and its stakeholders. For example, the findings of various studies by TAS and others are consistent with what the IRS and Congress found in 1989 – penalties promote voluntary compliance when they are perceived as fair and administered in a way that is consistent with fundamental

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**In response to a TAS request, OSP did not identify any significant changes to IRS-wide penalty policy that it had implemented to enhance voluntary compliance in the last ten years.**

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42 IRS response to TAS information request (July 10, 2014) (indicating that the business units merely asked OSP for new penalty reference numbers).

43 GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* (June 2009).

44 IRS response to TAS information request (July 10, 2014).

45 *Id.*

46 *Id.*

taxpayer rights.<sup>47</sup> Otherwise, they are more likely to erode voluntary compliance, wasting IRS resources and decreasing government revenues. This conclusion is also consistent with the IRS's recently-adopted Taxpayer Bill of Rights.<sup>48</sup> If OSP were more effective in protecting those core principles and conducting research or reviewing research by TAS and other stakeholders, it could better ensure that penalty rules and administration actually promote voluntary compliance.

## RECOMMENDATION

The National Taxpayer Advocate recommends that the IRS:

1. Finalize a plan for OSP (or a successor organization) to ensure that all parts of the IRS are administering penalties to promote voluntary compliance in accordance with congressional directives and the IRS policy statement.
2. Provide OSP with sufficient authority, resources, staffing, training, and access to data and systems to ensure the IRS is achieving its penalty-related objectives.
3. Require that all penalty policies and initiatives owned by other IRS business units be incorporated into the IRM and substantively reviewed by OSP for consistency with IRS-wide penalty policy before they are implemented. OSP should also review all previously-adopted policies.
4. Direct OSP to partner with private-sector researchers to study the effect of penalties on voluntary compliance.
5. Direct OSP to compile, review, and consider current and historical internal and external penalty studies (including TAS studies) in connection with any reevaluation of (or change to) IRS penalty policy or administration.
6. Direct OSP to publish the studies it considers and the conclusions it reaches after any such review, so that internal and external IRS stakeholders can build on and contribute to its analysis.

<sup>47</sup> A number of studies other than those described above lend support to this conclusion. See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, at 13 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, § 6 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance*) (describing wide range scholarly studies); Swedish Tax Agency, *Right From The Start, Research and Strategies* 38-51 (Aug. 2005) (surveying papers from various disciplines, and concluding that trust for tax agencies is an important determinant of voluntary compliance); Kristina Murphy, *The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders*, 28 LAW & HUM. BEHAV 187 (Apr. 2004) (finding that perceptions of procedural fairness and trust in the taxing authority had an impact on the motivation to comply); Tom R. Tyler, *Why People Obey the Law* 58-62 (Princeton Univ. Press 2006) (finding that respect and support for enforcement agencies has a significant positive impact on compliance after controlling for other variables); *Taxpayer Compliance, Volume 1: An Agenda for Research* 118 (Jeffrey A. Rother, John T. Scholtz, and Ann Dryden Witte eds., Univ. of Penn. Press 1989) (summarizing various studies that suggest attitudes toward the IRS, law, and government may have an impact on tax compliance). See also Joint Committee on Taxation, JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 19 (Nov. 24, 1998) (describing the 1998 IRS reorganization as needed to restore public confidence in the IRS, in large part, because “the Congress believed that most Americans are willing to pay their fair share of taxes, and that public confidence in the IRS is key to maintaining that willingness.”). Of course, penalties may also deter noncompliance and demonstrate the fairness of the tax system to those who are compliant. Policy Statement 20-1 (Formerly P-1-18), *reprinted as IRM 1.2.20.1.1(1)-(2)* (June 29, 2004).

<sup>48</sup> The notion that only penalties that are perceived as being fair and administered fairly have a positive effect on voluntary compliance is so well established that GAO suggested: “In addition to analyses related to voluntary compliance that could be done internally, by developing a plan, OSP may be able to identify other means of developing information useful to gauging penalties’ effect on voluntary compliance. Taxpayer surveys or focus groups, for instance, could provide information on taxpayers’ perceptions about the fairness of penalties.” GAO, GAO-09-567, *IRS Should Evaluate Penalties and Develop a Plan to Focus Its Efforts* 10 (June 2009).

MSP  
#9**COMPLEXITY: The IRS Does Not Report on Tax Complexity as Required by Law****RESPONSIBLE OFFICIALS**

John A. Koskinen, Commissioner of Internal Revenue  
Rosemary Marcuss, Director, Office of Research, Analysis, and Statistics

**DEFINITION OF PROBLEM**

The IRS is required by law to report to Congress each year on the sources of complexity in tax administration and on ways to reduce it.<sup>1</sup> However, the IRS has issued only two such reports and none since 2002.<sup>2</sup> Congress adopted many of the recommendations in those reports. As the tax administrator, only the IRS has certain data about complexity, and its short reports probably helped both the IRS and Congress to identify and address key problem areas. Thus, the IRS's decision to discontinue the reports has likely contributed to tax complexity, which burdens taxpayers and the IRS alike. Conversely, revisiting this decision could help improve tax law clarity, administrability, and fairness. If the IRS did this, it would further the taxpayer *rights to be informed* (e.g., to know and understand what they need to do to comply), *to quality service* (e.g., to receive clear and easily understandable communications from the IRS), and *to a fair and just tax system*.<sup>3</sup>

**ANALYSIS OF PROBLEM****Congress Requires the IRS to Analyze and Report on Complexity.**

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to analyze and report on the sources of complexity in tax administration each year.<sup>4</sup> Specifically, RRA 98 § 4022(a) states:

- (1) In general.--The Commissioner of Internal Revenue shall conduct each year after 1998 an analysis of the sources of complexity in administration of the Federal tax laws. Such analysis may include an analysis of—
- (A) questions frequently asked by taxpayers with respect to return filing;
  - (B) common errors made by taxpayers in filling out their returns;
  - (C) areas of law which frequently result in disagreements between taxpayers and the Internal Revenue Service;
  - (D) major areas of law in which there is no (or incomplete) published guidance or in which the law is uncertain;

1 See Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105–206, Title IV, § 4022(a), 112 Stat. 785 (1998) (codified at Internal Revenue Code (IRC) § 7801(note)).

2 IRS, Office of Research Analysis and Statistics, *Annual Report from the Commissioner of Internal Revenue on Tax Law Complexity*, Pub. 4105 (June 5, 2000) [hereinafter 2000 Complexity Report]; IRS, Office of Research Analysis and Statistics, *Annual Report from the Commissioner of Internal Revenue on Tax Law Complexity*, Pub. 4105 (Sept. 20, 2002) [hereinafter 2002 Complexity Report].

3 See IRS, Pub. 1, *Your Rights as a Taxpayer* (2014).

4 RRA 98 § 4022(a) (codified at IRC § 7801(note)).

(E) areas in which revenue officers make frequent errors interpreting or applying the law;<sup>5</sup>

(F) the impact of recent legislation on complexity; and

(G) forms supplied by the Internal Revenue Service, including the time it takes for taxpayers to complete and review forms, the number of taxpayers who use each form, and how recent legislation has affected the time it takes to complete and review forms.

(2) Report.--The Commissioner shall not later than March 1 of each year report the results of the analysis conducted under paragraph (1) for the preceding year to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

The report shall include any recommendations—

(A) for reducing the complexity of the administration of Federal tax laws; and

(B) for repeal or modification of any provision the Commissioner believes adds undue and unnecessary complexity to the administration of the Federal tax laws.

The Joint Committee on Taxation (JCT) explained the reason for the provision as follows:

The National Commission on Restructuring the IRS found a clear connection between the complexity of the Internal Revenue Code and the difficulty of tax law administration and taxpayer frustration. The Committee shares the concern that complexity is a serious problem with the Federal tax system. Complexity and frequent changes in the tax laws create burdens for both the IRS and taxpayers. Failure to address complexity may ultimately reduce voluntary compliance....

In some cases other policies, such as fairness, may outweigh concerns about complexity. Nevertheless, the Congress believed complexity of the tax system should be reduced whenever possible. Accordingly, the Congress believed ... that the tax-writing committees should receive periodic input from the IRS regarding areas of the law that cause problems for taxpayers. This input will be valuable in developing future legislation.<sup>6</sup>

In other words, Congress required the IRS to prepare an annual complexity report to highlight administrative and legislative changes that could reduce complexity and taxpayer frustration, while improving voluntary tax compliance. In addition, Congress suggested that the report include data that would aid Congress in crafting future legislation, and also enable Congress to determine that taxpayer protections were being followed (*e.g.*, by reporting where revenue officers make frequent errors).

The tax code is so complicated that it is probably difficult for most members of Congress to know how to simplify it without large-scale tax reform. However, large-scale tax reform does not happen very often. In the meantime, Congress might be able to make steady progress toward simplification if it had a data-driven road map to highlight the areas of complexity that are causing the most problems for taxpayers and the IRS. The IRS is uniquely positioned to provide Congress with that map, which is what it is required to do under RRA 98 § 4022(a).

<sup>5</sup> The IRS's complexity reports identified the areas of the tax code where revenue agents (not revenue officers) made frequent errors, but the IRS no longer tracks tax law errors by code section. IRS response to TAS information request (June 5, 2014); IRS response to TAS fact check (Oct. 30, 2014) (clarifying the IRS could identify the code sections that were the source of frequent errors by reviewing a sample of cases where employees were deemed to have made tax law errors). In general, a revenue agent audits returns, whereas a revenue officer collects tax assessments.

<sup>6</sup> Joint Committee on Taxation (JCT), JCS-6-98, *General Explanation of Tax Legislation Enacted in 1998*, 142-143 (Nov. 24, 1998).

## Tax Complexity Remains a Costly and Burdensome Problem for the IRS and Taxpayers Alike.

The complexity of the tax code, which has reached nearly four million words, continues to burden taxpayers and drain IRS resources.<sup>7</sup> According to a tally compiled by a leading publisher of tax information, there have been approximately 4,107 changes to the tax code since 2004, an average of more than one a day.<sup>8</sup> The number of IRC sections, subsections and cross-references increased by 46 percent (from 45,789 to 66,812) between 1991 and 2012.<sup>9</sup> Individual taxpayers find return preparation so overwhelming that about 94 percent of them used a preparer or tax software in processing year (PY) 2013.<sup>10</sup>

### Internal Revenue Code growth, 1991-2012



While preparers' fees vary widely, leading software packages often cost \$50 or more.<sup>11</sup> For 2007, IRS researchers estimated the monetary compliance burden of the median individual taxpayer (as measured by income) was \$258.<sup>12</sup>

It is difficult to quantify the additional costs to the government of increasing complexity. However, tax expenditures—rules that contribute to complexity by providing special tax benefits to certain taxpayers—are estimated at about \$1.4 trillion for fiscal year (FY) 2015.<sup>13</sup> Tax expenditures also increase IRS operating costs. As one example, for FY 2015 the Treasury Department requested about \$452 million for the IRS to administer the recently-enacted Affordable Care Act (ACA) program for one year.<sup>14</sup>

- 7 See National Taxpayer Advocate 2012 Annual Report to Congress 3–23; National Taxpayer Advocate 2010 Annual Report to Congress 3–14; National Taxpayer Advocate 2008 Annual Report to Congress 3–14; see also *Hearing on Fundamental Tax Reform: Hearing Before the H. Comm. on Ways and Means*, 112th Cong. (2011) (statement of Nina E. Olson, National Taxpayer Advocate).
- 8 Email from Wolters Kluwer, Commerce Clearing House (CCH) to TAS (Sept. 29, 2014). This data does not include changes after September 29, 2014. 4,107 changes divided by 3,924 days (365 per year, plus four leap days, and 271 days in 2014) equals 1.05 changes per day.
- 9 Rosemary Marcuss *et. al.*, *Income Taxes and Compliance Costs: How are They Related?*, 66(4) N. Tax J. 833–54 (Dec. 2013).
- 10 IRS Compliance Data Warehouse, Individual Returns Transaction File (Oct. 23, 2014).
- 11 See, e.g., TurboTax, <https://turbotax.intuit.com/personal-taxes/compare.jsp> (last visited Oct. 1, 2014) (listing paid software prices ranging from \$39.99 to \$99.99, with all but “basic” priced at or above \$49.99).
- 12 George Contos, John Guyton, Patrick Langetieg & Melissa Vigil, *Individual Taxpayer Compliance Burden: The Role of Assisted Methods in Taxpayer Response to Increasing Complexity* 26 (presented at IRS Research Conference, June 2010).
- 13 See Office of Management and Budget, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2015*, Table 14–1, at [http://www.whitehouse.gov/omb/budget/Analytical\\_Perspectives/](http://www.whitehouse.gov/omb/budget/Analytical_Perspectives/). See also Staff of the JCT, 112th Cong., JCS-1–13, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017* (Feb. 1, 2013), at <https://www.jct.gov/publications.html?func=select&id=5> (listing about \$1.348 billion in tax expenditures).
- 14 U.S. Department of Treasury, IRS, *The Budget in Brief 20* (FY 2015), <http://www.irs.gov/uac/Strategic-Plan-and-Other-References>.

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**While the IRS would need to spend some resources to produce the complexity report, these costs pale in comparison to the costs of complexity.**

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IRS employees also require more training to administer complex provisions. Moreover, tax complexity can create ambiguities that lead to tax shelters and a loss of confidence by the public in the fairness of the tax code. As a result, complexity can lead to a reduction in voluntary tax compliance and revenue.

While the IRS would need to spend some resources to produce the complexity report, these costs pale in comparison to the costs of complexity.<sup>15</sup> Moreover, if they prompt a reduction in tax complexity, the reports might ultimately help the IRS do its job and reduce the cost of administering the tax code.

### According to the IRS, Reducing Complexity Furthers its Mission.

In its first complexity report, the IRS explained that complexity reduction furthers its mission, as follows:<sup>16</sup>

Aside from the requirements of RRA 98, the Service believes complexity must be addressed to effectively reduce taxpayer burden and improve taxpayer compliance, two key components of the Service's mission. Reducing complexity can reduce taxpayer burden by reducing the time and costs taxpayers face in meeting their tax obligations and increase compliance by making those same obligations easier to understand and meet. Reducing complexity also will make it easier for Service employees to do their jobs of providing services to taxpayers and enforcing the law....

Reducing complexity is important to the success of the Service. The mission of the Service is to '[P]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all' .... Reducing complexity will aid the Service in achieving all of its strategic goals. By reducing burden, the IRS better serves each taxpayer. By increasing compliance, IRS better serves all taxpayers. In making the Code less complex, the working environment for IRS employees becomes more productive.<sup>17</sup>

In other words, if the complexity report helps reduce complexity, it also helps the IRS achieve its mission.

### The IRS's Two Complexity Reports Helped Reduce Complexity, as Intended.

The process of drafting the complexity reports prompted the IRS to analyze all of the information suggested by Congress, and consult with stakeholders, such as tax preparation software vendors, practitioners,

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15 In response to a request for an estimate of the resources the IRS would need to produce the complexity report, the IRS's Research, Analysis and Statistics (RAS) function stated that "as an order of magnitude" a paper that examined the relationship between tax complexity and income tax compliance required about two full time employees working for about a year. IRS response to TAS information request (June 20, 2014). It later clarified that it had no information about the resources required by other functions to assist or coordinate this work. IRS response to TAS information request (Oct. 27, 2014). It noted that the previous complexity reports required considerable data extraction and verification from IRS units, and the issue identification, development and recommendations in the previous reports required significant coordination and collaboration with Treasury's Office of Tax Analysis. IRS response to TAS information request (Oct. 30, 2014).

16 The IRS mission is to "[P]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all." Internal Revenue Manual 1.1.1.1, *The IRS Mission* (Mar. 1, 2006).

17 2000 Complexity Report at 4.

academics, and IRS employees who interact with taxpayers. This activity prompted policymakers within the IRS to make forms and instructions easier to understand.<sup>18</sup>

In addition, Congress ultimately adopted many of the reports' recommendations. In the 2000 complexity report, which was only 40 pages (excluding Appendix), the IRS provided options for reducing complexity associated with three issues: filing definitions, the individual Alternative Minimum Tax (AMT), and estimated taxes.<sup>19</sup> Other stakeholders (such as the National Taxpayer Advocate) made similar and more detailed proposals, and Congress ultimately adopted at least one of the IRS's recommendations in each of those areas:<sup>20</sup>

- Creating a uniform definition of a “qualifying child;”<sup>21</sup>
- Indexing the individual AMT exemption for inflation;<sup>22</sup> and
- Keeping the estimated tax safe harbor threshold constant.<sup>23</sup>

Similarly, in the 2002 report, which was still only 52 pages (excluding Appendix) the IRS highlighted options for reducing complexity associated with three more issues: personal credits, deductions and exemptions, and capital gains.<sup>24</sup> As with the 2000 report, Congress ultimately enacted at least one of the IRS's suggestions in each of those areas:

- Creating a uniform definition of a “qualifying child” for purposes of personal credits (as noted above);
- Coordinating the personal exemption and itemized deduction phase-out ranges;<sup>25</sup> and
- Reducing the number of capital gains rates.<sup>26</sup>

Given the seeming success of these relatively short reports that tackled only three issues each, the tax system would likely be simpler if the IRS had not discontinued them. According to the IRS, taxpayers have the *right to be informed* (e.g., know and understand what they need to do to comply), *to quality service* (e.g., to receive clear and easily understandable communications from the IRS), and *to a fair and*

18 *Id.* at 11.

19 2000 Complexity Report at 1–2.

20 Others may have been adopted or included in bills, but the IRS was unable to identify any legislative activity associated with these particular recommendations. IRS response to TAS information request (July 15, 2014).

21 Working Families Tax Relief Act of 2004, Pub. L. No. 108–311, § 201, 118 Stat. 1166, 1169–1175 (2004) (enacting uniform definition of a qualifying child). The National Taxpayer Advocate and other stakeholders, including the American Bar Association (ABA) and the American Institute of Certified Public Accountants (AICPA) and the Tax Executives Institute (TEI), made similar and more comprehensive recommendations. See, e.g., National Taxpayer Advocate 2001 Annual Report to Congress 78–100; ABA/AICPA/TEI Tax Simplification Recommendations (Sept. 13, 2002) (Attachment A).

22 The American Taxpayer Relief Act of 2012 (ATRA), Pub. L. No. 112–240, 126 Stat. 2317 (Jan. 2, 2013) (indexing the AMT exemption amount for inflation). The National Taxpayer Advocate and other stakeholders made similar recommendations. See, e.g., National Taxpayer Advocate 2001 Annual Report to Congress 82–100.

23 The National Taxpayer Advocate had also observed that fluctuation of the estimated tax penalty threshold was a problem requiring a legislative solution. See, e.g., National Taxpayer Advocate 2001 Annual Report to Congress 256. The threshold has remained at 110 percent of the tax shown on the prior year return for about the last ten years. See IRC § 6654(d)(1)(C)(i).

24 2002 Complexity Report at 9.

25 ATRA, Pub. L. No. 112–240, Title I, § 101(b)(2), 126 Stat. 2313, 2317 (Jan. 2, 2013) (codified at IRC §§ 68(b) and 151(d)(3)) (modifying the personal exemption phase-out (PEP) threshold amounts to be the same as those applicable to the limitation on itemized deductions (called “Pease”), as recommended).

26 See The Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108–27, Title III, § 301, 117 Stat. 752, 758 (May 28, 2003) (amending IRC § 1(h) and 55(b) to eliminate two capital gains rates for property held for five years or more).

*just tax system.*<sup>27</sup> Thus, if these reports ultimately improved tax law clarity, administrability, and fairness, they would promote these fundamental taxpayer rights.

Moreover, by issuing complexity reports, the IRS could show taxpayers that it understands the burden the tax laws impose on them, and that it is not always the cause of the problem—sometimes the law itself is the problem. Thus, regular complexity reports could also help to restore and maintain taxpayers' faith in the fairness of the tax system.

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...Congress might be able to make steady progress toward simplification if it had a data-driven road map to highlight the areas of complexity that are causing the most problems for taxpayers and the IRS.

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## CONCLUSION

The complexity reports, which are typically relatively short, addressing only three issues each, provide a road map for stakeholders to address tax law complexity. This roadmap could help Congress improve tax law clarity, administrability, and fairness, thereby reducing burden and promoting fundamental taxpayer rights. Moreover, the reports could encourage the IRS to track how its employees are applying and observing taxpayer protections, specifically in the collection area.

Because complexity affects different taxpayers in different ways, the complexity reports could address the complexity facing different taxpayer segments. For example, over a rolling five-year period the IRS could issue one report addressing complexity faced by each of five different taxpayer groups, such as domestic individuals, tax exempt and government entities, international individuals and businesses, small business and self-employed taxpayers, and large businesses. In the sixth year, the IRS could revisit the complexity still facing the taxpayers discussed in the first report. If structured this way, the IRS's complexity reports are more likely to help Congress and other stakeholders address complexity faced by taxpayers throughout the tax system.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends the IRS:

1. Analyze and report to Congress each year on the sources of complexity in tax administration and on ways to reduce it, as required by law.
2. Issue a report addressing the complexity faced by a different taxpayer segment each year over a rolling multi-year period so that these reports address the complexity faced by taxpayers throughout the tax system.
3. Include in the complexity report all of the data suggested by Congress, including areas where employees make frequent errors interpreting or applying the law (*e.g.*, the errors collection employees make in applying taxpayer protection provisions).

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<sup>27</sup> See IRS, Pub. 1, *Your Rights as a Taxpayer* (2014).

**MSP  
#10****COMPLEXITY: The IRS Has No Process to Ensure Front-Line Technical Experts Discuss Legislation with the Tax Writing Committees, as Requested by Congress****RESPONSIBLE OFFICIALS**

John A. Koskinen, Commissioner of Internal Revenue  
Terry Lemons, Chief, Communications and Liaison

**DEFINITION OF PROBLEM**

Pursuant to the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), the tax-writing committees in Congress should hear from “front-line technical experts” at the IRS with respect to the “administrability” of pending amendments to the tax code.<sup>1</sup> However, the IRS has not established a process to encourage such discussions. Congress is more likely to enact tax laws that are simpler, more taxpayer-focused, and easier for taxpayers to comply with and for the IRS to administer if it receives current and relevant information from front-line technical experts who communicate with taxpayers on a regular basis. If such information empowered Congress to write tax laws that were more fair and easier to understand and administer, it would also promote the taxpayer rights to a *fair and just tax system* and to *quality service*.<sup>2</sup> The IRS should seize the opportunity to implement RRA 98’s recommendation to help Congress write better laws.

**ANALYSIS OF PROBLEM****Front-line Technical Experts at the IRS Are in a Good Position to Identify Ways to Improve Tax Administration.**

When developing recommendations to restructure and reform the IRS in 1997, the National Commission on Restructuring met privately with over 500 individuals, including senior-level and front-line IRS employees across the country.<sup>3</sup> The Commission apparently felt that front-line employees were uniquely qualified to offer good suggestions about how to improve tax administration because they could see how the law affected taxpayers one at a time.<sup>4</sup>

1 RRA 98, Pub. L. No. 105-206, Title IV, § 4021, 112 Stat. 685, 785 (1998).

2 See IRS, *Publication 1, Your Rights as a Taxpayer* (2014).

3 The Report of the National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* 5 (June 25, 1997). The National Commission included bipartisan representatives from Congress, the IRS, Treasury, and major external stakeholder groups. *Id.*

4 Similarly, in his first four months on the job, the current IRS Commissioner visited 25 cities and met about 10,000 IRS employees because “leaders can learn a lot by talking with and listening to people on the front lines.” Email from IRS Commissioner to all IRS employees, *Listening to you in 25 cities and finding improvements* (Apr. 24, 2014); *IRS improvement recommendations* (Apr. 14, 2014). As a result of suggestions the Commissioner received from front-line employees, the IRS immediately initiated a wide range of reforms. *Id.*

### Congress Asked to Hear from Front-line Technical Experts About How Pending Tax Legislation Could Be Simpler and Easier to Administer.

The bipartisan report of the National Commission on Restructuring the IRS recommended that: “Congress hear an uncensored view of the administrability of all tax legislative proposals from the IRS,” just as it had done in formulating its own recommendations.<sup>5</sup> According to the House Report:

The Committee also believes that encouraging the participation of IRS personnel in drafting legislation will help to highlight administrative and complexity issues while legislation is being developed.<sup>6</sup>

Then-Representative Portman, a co-chairman of the Commission, further explained:

Despite claims of the Treasury Department to the contrary, *front-line* IRS employees consider the complexity of the Internal Revenue Code to be a major obstacle. The commission conducted a survey of almost 300 front-line IRS employees, and they overwhelmingly felt that the complexity of the Tax Code impedes their work... The commission proposes to give the IRS a voice in the legislative process. In a very real sense, the IRS will serve as an advocate for Tax Code simplicity.<sup>7</sup>

Congress refined the proposal and asked to hear directly from “front-line technical experts” at the IRS. Section 4021 of RRA 98 provides:<sup>8</sup>

It is the sense of the Congress that the Internal Revenue Service should provide Congress with an independent view of tax administration, and that during the legislative process, the tax writing committees of Congress should hear from front-line technical experts at the Internal Revenue Service with respect to the administrability of pending amendments to the Internal Revenue Code of 1986.

By discussing proposals with “front-line” employees who, by definition, regularly interact with taxpayers, Congress could get a sense of how proposals might affect such interactions. If the employees were also “technical experts,” they would be more likely to understand how changes to the law might affect these contacts and other IRS procedures.

In addition, if the IRS could facilitate more uncensored, unfiltered group discussions between members of Congress and their staffs and front-line technical experts in various areas of tax administration on an ongoing basis, Congress would gain a better foundational understanding of tax administration.<sup>9</sup> Congress might also better understand the challenges facing employees charged with administering an almost impossibly complex tax code, and be less likely to vilify them. Thus, RRA 98 provided the IRS with an opportunity to open this important dialogue, which could help Congress draft better laws.

<sup>5</sup> The Report of the National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS* § 6 (June 25, 1997), <http://www.house.gov/natcommirs/report1.pdf>.

<sup>6</sup> H.R. Rept. 105-364 at 86-67 (1997).

<sup>7</sup> 105 Cong. Rec. E1605 (Aug. 1, 1997) (statement of Cong. Portman) (emphasis added). See also 105 Cong. Rec. S4187 (May 4, 1998) (statement of Sen. Johnson) (“front-line IRS technical experts should be heard during congressional consideration of tax legislation in an effort to avoid additional complexity to the Tax Code.”).

<sup>8</sup> RRA 98, Pub. L. No. 105-206, Title IV, § 4021, 112 Stat. 685, 785 (1998).

<sup>9</sup> The IRS Commissioner could still select the specific front-line technical experts to represent the IRS in discussing issues with members of Congress and their staff, just like the National Taxpayer Advocate selects Local Taxpayer Advocates who sometimes meet with them. See, e.g., Internal Revenue Manual (IRM) 13.1.8, *Congressional Affairs Program* (Feb. 27, 2012).

Such laws would probably be more fair or at least easier to understand and administer. If so, then establishing a process to facilitate discussions between Congress and front-line technical experts would also promote the taxpayer rights to a *fair and just tax system* and to *quality service*.<sup>10</sup>

### The IRS Does Not Have a Process to Ensure Front-line Technical Experts Offer Comments on Pending Legislation or Communicate with Congress.

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When legislation is crafted with smooth tax administration in mind, and is informed by discussions with the front-line employees who may have to explain it to taxpayers, it is likely to be simpler, less burdensome, more taxpayer-focused, and easier to administer.

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Following enactment of RRA 98, the IRS did not implement section 4021.<sup>11</sup> When the IRS receives a request to comment on pending legislation, the Office of Legislative Affairs generally seeks the views of the business operating divisions (BODs).<sup>12</sup> It does not specifically seek the views of front-line technical experts.<sup>13</sup> Nor does it ask to bring them before Congress or even identify them for Congress.

According to the IRS, Legislative Affairs “shares these requests with the appropriate [Business Operating Divisions] BOD(s) on a case-by-case basis. The BOD(s) will solicit comments from ‘front line technical experts’ as needed, again on a case-by-case basis.” The IRS could not identify any front-line technical expert(s) who had ever been consulted.<sup>14</sup> Thus, the IRS has no process to ensure that front-line technical experts are consulted, given the opportunity to discuss the administrability of pending legislation with the tax-writing committees, or even identified for these committees or their staff either on a regular basis or in connection with specific pending legislation.

### The IRS Could Simply Expand Existing Procedures to Ensure Congress Can Hear From Front-line Technical Experts.

When Legislative Affairs identifies pending tax legislation that Congress would like to discuss, it could simply ask the BODs to identify front-line technical experts who could address administrability issues, rather than waiting for Congress to ask to hear from them.<sup>15</sup> Once Legislative Affairs identifies these experts, it could suggest that Congress convene a group discussion with them. Even if Congress declines such an offer, once the IRS identifies the front-line technical experts, Congress may be more likely to open a dialogue with them about tax administration. Such communications can be critically important. When legislation is crafted with smooth tax administration in mind, and is informed by discussions with

<sup>10</sup> See IRS, *Publication 1, Your Rights as a Taxpayer* (2014).

<sup>11</sup> According to an IRS database that tracks the steps it takes to implement various provisions, the IRS’s only activity in response to RRA 98 § 4021 was to “[A]dvise JCT and Treasury that Legislative Affairs is the contact point” on December 28, 1998. IRS, *Enacted Law Report – Actions*, AT-2009-13387 (May 28, 2014). When asked about what other actions it took to implement this provision, the IRS did not identify any. IRS response to TAS information request (July 15, 2014).

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* The IRS later clarified that it does not maintain a list of these communications and did not create one in response to TAS’s information request. IRS response to TAS information request (Nov. 20, 2014). It asserted that technical experts may be consulted and described a recent situation in which a legislative liaison solicited comments on pending legislation from a Revenue Officer Technical Advisor (RATA) in response to a request from Congress. *Id.* However, the response did not indicate that the RATA was a front-line employee. *Id.*

<sup>15</sup> There would be no need to change the IRS’s existing policy of authorizing only certain employees to comment on legislation. See, e.g., IRM 11.5.2.5, *Legal and Policy Considerations* (Sept. 1, 2014) (“Comments on legislation may only be made with the approval of the Commissioner or designee, and must be limited to the administrative aspects of the legislation”); Policy Statement 11-87 (Formerly P-1-24) (Aug. 12, 1976). Currently, only the Director of Legislative Affairs has been delegated this authority. IRS response to TAS information request (July 15, 2014). This restriction is inapplicable to TAS, given its statutory mandate, and the Governmental Liaison function. IRM 11.5.2.5, *Legal and Policy Considerations* (Sept. 1, 2014).

the front-line employees who may have to explain it to taxpayers, it is likely to be simpler, less burdensome, more taxpayer-focused, and easier to administer.

## CONCLUSION

If the IRS establishes a process by which it automatically identifies specific front-line technical experts who can discuss the administrability of pending (or existing) legislation directly with the tax-writing committees, then members of Congress and their staff are more likely to consult with these experts before finalizing legislation, and that legislation is likely to be simpler, easier for taxpayers to understand and for IRS employees to administer. Such laws would better effectuate the taxpayer rights to *a fair and just tax system* and *quality service*.<sup>16</sup>

## RECOMMENDATION

The National Taxpayer Advocate recommends the IRS establish a process to automatically provide the tax writing committee staff with a list of specific front-line technical experts who can discuss the administrability of pending (or existing) legislation directly with the tax-writing committees, as provided by RRA 98, without waiting for a specific request from the tax-writing committees.

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<sup>16</sup> See IRS, *Publication 1, Your Rights as a Taxpayer* (2014).

**MSP  
#11****WORKLOAD SELECTION: The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
Karen Schiller, Commissioner, Small Business/Self-Employed Division  
Sunita B. Lough, Commissioner, Tax Exempt/Government Entities

**DEFINITION OF PROBLEM**

The IRS generally strives to audit only taxpayers it believes are not in compliance with the tax laws.<sup>1</sup> At the same time, it cannot audit every return it believes contains an error. Congressional bodies have recommended that the IRS select returns to audit on the basis of research, with the goal of not only correcting errors, but also enhancing *future* tax compliance.<sup>2</sup> For tax administration today, the research required to carry out this recommendation is broader than just numbers derived from tax returns, and a successful audit strategy is broader than just the audit.

IRS audit selection processes should support the Taxpayer Bill of Rights (TBOR) by comprising part of an overall compliance strategy—one that will drive future compliance, not only by the taxpayer under audit, but also by other taxpayers in similar situations.<sup>3</sup> Because a compliance strategy based on applied and behavioral research allows the IRS to adopt the least intrusive enforcement measure necessary in light of known taxpayer behaviors and motivators, it protects taxpayers' *right to privacy*. Because such a strategy reaches noncompliant taxpayers and addresses their outstanding tax liabilities, it promotes taxpayers' *right to finality*. Using research about taxpayers' characteristics and behaviors to design a compliance strategy that takes into account their facts and circumstances promotes the right to a *fair and just tax system*.

- 1 See, e.g., Internal Revenue Manual (IRM) 4.22.1.5, *Benefits of NRP* [National Research Program] (Oct. 1, 2008), noting "The IRS should audit those returns most likely to have errors. Various methods are used to identify errors with the most common method using Discriminant Function (DIF) formulas [discussed below] to select returns for examination."
- 2 See National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 26-7 (1997). See also H.R. 2292, 105th Cong. (1998) and S. 1096, 105th Cong. (1997) that culminated in the IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685 (1998), referencing the need for targeted compliance and enforcement initiatives, in addition to taxpayer service and education.
- 3 Taxpayer Bill of Rights (TBOR), available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>.

In order to succeed, however, such a strategy must be based on various types of data—numeric, return-based,<sup>4</sup> geographic,<sup>5</sup> demographic,<sup>6</sup> socio-demographic,<sup>7</sup> and psychographic<sup>8</sup>—as well as the impact of tax morale and the impact of perceptions of fairness on tax compliance.<sup>9</sup> It should incorporate not only audits but also education and outreach that leverage partner relationships and it should include an effective communication strategy.<sup>10</sup>

The IRS has not integrated this type of research into an overarching compliance strategy, essentially because it perceives doing so as too difficult.<sup>11</sup> The IRS claims to recognize the value of a holistic approach to encouraging compliance, but it actually intends to continue to base its compliance initiatives primarily, if not exclusively, on tax data.<sup>12</sup> Without a more expansive definition of research to drive its initiatives, and without using pilots to test and evaluate initiatives before implementing them, IRS compliance initiatives will not drive future compliance. Audit selection will continue to be only a tactic rather than part of an overall compliance strategy.

4 As discussed below, the IRS generally selects returns for audit on the basis of return characteristics or numeric targets.

5 See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 1-70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*) (discussing TAS's survey of taxpayers at random in certain communities which revealed, among other things, that taxpayers with low compliance levels clustered in geographic communities, while those with high compliance levels were more dispersed).

6 See, e.g., Russell Research, *Findings From The TAS Benchmark Awareness & Usage Study* (2002), report prepared for the IRS and Cossette Post, showing that the underserved taxpayer audience divided into seven segments based upon demographics, behavior, and personal situations: Surviving Spouses; Struggling Young Families; Unmarried Low Income; Affluent Families; Empty Nesters; Stable Middle Class; and Income Secretive.

7 See, e.g., Russell Research, *Report Of Findings From 2007 Market Research For The Taxpayer Advocate Service* (2007), report prepared for TAS, updating its 2002 report and also segmenting taxpayers on a socio-demographic basis: Affluent Families; Upper-Middle Unmarrieds; Middle-Income Families; Low-Income Singles; Low-Income Families; and Financially Distressed.

8 See, e.g., Russell Research, *Report Of Findings From 2007 Market Research For The Taxpayer Advocate Service* (2007), report prepared for TAS, updating its 2002 report and identifying an additional segment of underserved taxpayers based on attitudes toward the IRS and TAS: Rejectors; Distrusters; Indifferents; Acceptors; Doubters; and Believers.

9 See National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 138-80 (Research Study: *Marjorie Kornhauser, Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*) noting: “[t]raditional methods of enforcement through audit and penalties explain only a small fraction of voluntary tax compliance. Theorists and researchers attribute the vast majority of compliance to what they loosely describe as internal motivations or ‘tax morale.’”

10 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 27 (1997), noting that “[t]axpayer education is core to voluntary compliance. There are many facets to taxpayer education, including outreach programs, post office and library programs, small business education programs, programs at post and secondary educational institutions, practitioner education, pro bono tax clinics, emergency assistance, media information programs, volunteer tax assistance, and the distribution of tax forms and publications. Professional educators and adult education techniques facilitate greater compliance by emphasizing education over enforcement. If properly designed, taxpayer education and outreach can be a proactive method of enhancing compliance.”

11 See, e.g., GAO 13-151, *TAX GAP IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* 26 (Dec. 2012).

12 Compare Internal Revenue Service FY 2015 Budget Request, Congressional Budget Submission 187, discussed below, available at [http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY\\_2015\\_CJ\\_Submission.pdf](http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY_2015_CJ_Submission.pdf) with W&I and SB/SE Compliance ConOps (Concept of Operations) v2.2, July 31, 2014, on file with the National Taxpayer Advocate. The ConOps, discussed below, indicates that W&I and SB/SE will attempt to use third-party data and will engage in limited pre-filing initiatives but the ConOps does not envision a comprehensive strategy based on research.

## ANALYSIS OF PROBLEM

### Background

#### *A Congressional Commission Directed the IRS to Adopt Audit Selection Processes that Would Prevent Noncompliance.*

The National Commission for Restructuring the IRS, noting that “[t]he IRS constantly struggles to ensure compliance with the tax law in a system that depends on citizens to voluntarily calculate and pay their taxes,” urged the IRS to select returns for audit on the basis of more than just discriminant index function formulas, or DIF scores.<sup>13</sup> Rather, the IRS was to use analytic tools to increase effectiveness of audit selection—and to “emphasiz[e] research to prevent noncompliance before it occurs.”<sup>14</sup>

Scholars have echoed the Commission’s recommendation, and pointed out the relevance of research in fields such as behavioral economics and psychology, cognitive psychology, and social psychology in understanding the dynamics of taxpayer compliance.<sup>15</sup> As one writer explained:

Research shows that tax compliance is affected by (social and personal) norms such as those regarding procedural justice, trust, belief in the legitimacy of the government, reciprocity, altruism, and identification with the group. Cognitive processes, such as prospect theory, also influence an individual’s reaction to tax issues. Studies also indicate that certain demographic factors such as age, gender and education correlate with tax morale.<sup>16</sup>

Similarly, the Senate Appropriations Committee has included the following language (or language that is almost identical) in its IRS appropriations bills for the past four fiscal years:

The Committee remains concerned that absent a better understanding of the current sources of noncompliance, efforts to improve compliance may be hampered, misdirected, and difficult to measure. To gain meaningful insights into taxpayer behavior, the Committee strongly supports the work of the National Taxpayer Advocate and the IRS Office of Research to examine factors that influence taxpayer compliance behavior, including how and the extent to which

13 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 26-7 (1997). IRM 4.19.11.1.5.1, *How DIF Works*, (Nov. 9, 2007), provides: “(1) DIF is a mathematical technique used to score income tax returns as to examination potential. (2) Under this concept, mathematical formulas are developed based on available TCMP data and are programmed into the computer. (3) The computer identifies returns by assigning weights to certain basic return characteristics. (4) These weights are added together to obtain a systemic composite score for each return processed. (5) This score is used to systemically rank the returns in numerical sequence (highest to lowest). (6) Generally, the higher the score the greater is the probability of significant tax change. (7) The highest scored returns are made available to Examination upon request. (8) DIF mathematical formulas are confidential in nature and are distributed to IRS personnel only on a need-to-know basis. (9) DIF formulas are for official use only and will not be discussed with unauthorized personnel. (10) Furthermore, the DIF score assigned to a return should not be disclosed. (11) Many returns, both individual and corporate, that are examined each year are DIF returns.”

14 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 26 (1997).

15 See National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 138-80 (Research Study: Marjorie Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

16 National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 138 (Research Study: Marjorie Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

various factors influence such behavior, and how the establishment of a cognitive learning and applied research laboratory might facilitate continued evaluation.<sup>17</sup>

*The IRS Selects Returns for Audit Without an Overall Compliance Strategy and Without Considering Audits' Effects on Future Compliance.*

The IRS selects examination work by taking into account one or more of the following:

- DIF scores indicating a high probability of noncompliance;<sup>18</sup>
- Scores assigned by or query results from other IRS systems that indicate a high probability of noncompliance or fraud;<sup>19</sup>
- A study or other analysis identifying “a group of individuals such as those within an occupation, industry, geographic area or specific economic activity or event” with compliance issues;<sup>20</sup>
- The anticipated amount of dollars to be assessed;<sup>21</sup>
- Anticipated no change-rates;<sup>22</sup>
- Emerging issues;<sup>23</sup>
- Referrals from the field;<sup>24</sup>
- Any requirement to examine a specific return;<sup>25</sup> and
- Special audit programs.<sup>26</sup>

17 S. REP. No. 113-80, at 25 (2013); S. REP. No. 112-177 (2012); S. REP. No. 112-79 (2011), S. REP. No. 111-238 (2010). The Senate Appropriations Committee has expressed its continued interest in this approach by including the same language in the draft of the FY 2015 appropriations bill it posted on its website. S. REP. No. 113-000, at 27 (2014), Financial Services and General Government Appropriations Bill, 2015, at 27, 113th Cong., (2014) (draft for use of the Committee and its staff only, in preparation for markup), available at <http://www.appropriations.senate.gov/sites/default/files/FSGG%20Report%20w%20Chart%2003REPT.PDF>.

18 See, e.g., IRM 4.19.11.1.4, *Sources of Returns for Classification*, (Nov. 9, 2007).

19 See, e.g., IRM 4.19.14.1, *Earned Income Tax Credit (EITC) Revenue Protection Strategy (RPS)*, (Nov. 25, 2011), noting “Exam receives the majority of its EITC work from the Dependent Data Base (DDb) and Electronic Fraud Detection System (EFDS).” The Tax Exempt and Government Entities (TE/GE) division uses software to analyze data from Forms 990, *Return of Organization Exempt From Income Tax*, to select some cases for examination. TE/GE response to TAS information request (Oct. 16, 2014).

20 See IRM 4.1.4.3.8, *Compliance Initiative Projects (CIP)*, (Oct. 24, 2006); TE/GE response to TAS information request (Oct. 16, 2014) (describing TE/GE's past use of questionnaires, e.g., for group exemption parents to “perform triage” in selecting cases for audit).

21 See, e.g., IRM 4.1.5.1.2, *Discriminant Function (DIF) System*, (Aug. 24, 2012) noting that “[m]any returns...that are examined each year are above the DIF cutoff score. Therefore, a significant portion of the classifiers' work will be to screen DIF returns,” and IRM 4.1.5.1.5.1.1, *Materiality – Significance of the Issue*, (Oct. 24, 2006), providing that “[c]lassifiers should compare the potential benefits to be derived from examining a return to the resources required to perform the examination. Although you may identify some potentially good issues on the return, if they would not yield a significant adjustment, the return should be accepted as filed.”

22 See, e.g., IRM 4.1.5.1.5.2, *Review of Performance*, (Aug. 24, 2012), noting that classifiers will be evaluated on whether their “[a]ccepted returns have little or no examination potential or if examined would probably result in no change cases.”

23 See, e.g., IRM 4.40.2.1.4.1, *Industry Knowledge and Expertise*, (Mar. 1, 2002), describing how Examination Technical Advisors “identify novel and/or controversial tax treatment of transactions” to assist in planning and developing audits of emerging issues.

24 See, e.g., IRM 4.23.3.1, *Overview*, (Jan. 25, 2011), noting that “The Employment Tax Examination Program is a lead-driven program.”

25 See, e.g., IRM 4.1.24.6.1.1, *Joint Committee Claims*, (Aug. 1, 2007) noting that “[a]ny tentative carryback allowance (form 1139) or claim (1120X), in excess of \$2,000,000 to the same taxpayer must be selected for examination. These claims meet Joint Committee criteria.”

26 See, e.g., 4.1.21.2.2.1, *Front End Loaded Planning Time*, (Aug. 1, 2007), noting that for some matters, such as cases with abusive tax avoidance transactions and coordinated industry cases, LB&I examination resources “are allocated, after consideration of work in process, prior to committing resources available to other compliance initiatives.”

None of these approaches involves considering the extent to which an audit plan would prevent non-audited taxpayers, or even the audited ones, from becoming or remaining noncompliant in the future, *i.e.*, audits' indirect effects. The IRS also selects returns to maintain audit "coverage ratios"—examining a given percentage of various categories of returns.<sup>27</sup> These audits may affect future noncompliance by influencing taxpayers' perceived threat of being audited, but the IRS does not establish coverage ratios on the basis of research about taxpayer behavior, or with the objective of maximizing these indirect effects.<sup>28</sup> Moreover, because none of these methods are based on applied or behavioral research that would allow the IRS to take into account taxpayers' facts and circumstances or calibrate its actions to be as least intrusive as possible, taxpayers' *right to a fair and just tax system* and *right to privacy* are impaired.<sup>29</sup>

The IRS does not attempt to measure, *post hoc*, the effect of an audit initiative on noncompliance. Its measures relate only to whether an audited return was in fact noncompliant and employees' effectiveness in carrying out the audit.<sup>30</sup> Because the IRS does not know whether its audits help taxpayers to avoid future audits, perhaps for the very same misstep, it cannot tell whether audits enhance taxpayers' *right to finality*. The IRS has been forthright about the shortcomings of its approach to allocating examination resources.<sup>31</sup>

### *Despite Language in its FY 2015 Budget Submission to Congress, the IRS Does Not Integrate Data About Taxpayer Behavior Into a Compliance Strategy.*

The IRS reported to Congress, in its FY 2015 budget request, that its Market Segmentation Compliance Program (MSCP):

seeks to establish a data-driven decision matrix for implementing approaches that work for the individual taxpayer. By integrating market segmentation with internal IRS data and certain external data, the IRS can incorporate taxpayer perspectives, compliance behavior, and attitudes to design and tailor compliance treatments so that the right treatment is delivered to the right taxpayer at the right time. RAS [IRS Research, Analysis and Statistics] is currently

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- 27 See Policy Statement P-4-21, 1.2.13.1.10 (June 1, 1974), noting the need to "select[] sufficient returns of all classes of returns in order to assure all taxpayers of equitable consideration" and IRS Statistics of Income Data Book Tables 9a, 9b, 10-13, available at <http://www.irs.gov/uac/SOI-Tax-Stats-IRS-Data-Book> for examples of various groups for which the IRS calculates audit coverage.
- 28 GAO 14-605, *IRS 2015 BUDGET Long-Term Strategy and Return on Investment Data Needed to Better Manage Budget Uncertainty and Set Priorities* 24 (June 2014), available at <http://gao.gov/products/GAO-14-605>. The IRS first attempted to quantify the indirect effects of audits on compliance levels in 1996. See Alan H. Plumley, *The Determinants of Individual Income Tax Compliance: Estimating the Impacts of Tax Policy, Enforcement, and IRS Responsiveness*, Publication 1916 (Rev. 8-96).
- 29 The TBOR *right to a fair and just tax system* includes the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. The *right to privacy* includes the right to expect that any IRS inquiry, examination, or enforcement action will be no more intrusive than necessary. TBOR, available at <http://www.taxpayeradvocate.irs.gov/About-TAS/Taxpayer-Rights>.
- 30 These measures include: Cases started; Cases closed; Time per case; Number of fraud referrals; Dollars per hour; Dollars per return; Total dollars assessed; Percentage of agreed cases; Amount of revenue protected; No change rate; Cycle time; Accuracy; Timeliness; and Professionalism. SB/SE response to TAS information request (July 17, 2014) and SB/SE Operating Division Fact Check (Dec. 19, 2014).
- 31 Internal Revenue Service FY 2015 Budget Request, Congressional Budget Submission 193, available at [http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY\\_2015\\_CJ\\_Submission.pdf](http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY_2015_CJ_Submission.pdf), noting "Net revenue is maximized only when resources are allocated according to marginal direct and indirect return on investment [ROI], but those ratios are much more challenging to estimate than the average ROI shown here." Similarly, the IRS responded to a 2012 GAO recommendation that "While we agree with your recommendation in principle, developing meaningful estimates of marginal and indirect effects remains a challenge as it will require improved data systems and new estimation techniques. These will take years to implement, not months." GAO 13-151, *TAX GAP IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* 26 (Dec. 2012).

working on an effort with enforcement programs, *i.e.*, Examinations, Collections, Offer in Compromise (OIC), and Underreporter, to influence and improve taxpayer compliance.<sup>32</sup>

The IRS went on to note:

Social science research reveals that the traditional deterrence theory, fear of detection and/or punishment, contributes a portion to actual compliance rates. Recent studies indicate that social norms, personal values, and attitudes may have a large impact on compliance decisions. Market segmentation approaches—behavioral, psychographic, and attitudinal, are widely used in commercial marketing to develop, design, and position products and services towards the right customer base. The knowledge gained from both social science and marketing research can assist the IRS with appropriate identification and alignment to the proper taxpayer. The MSCP is helping the IRS improve its methods of communication with taxpayers. For example, response rates from taxpayers improved after several notices were tailored for specific taxpayer segments.<sup>33</sup>

Despite these representations to Congress, the IRS informed TAS that it is not actually pursuing the MSCP. Instead, “[t]he market segmentation approach is still in a conceptual phase. It is being considered as part of the Compliance ConOps. At this time no decision has been made regarding the implementation of a market segmentation approach to compliance.”<sup>34</sup> In other words, the IRS continues to approach compliance, including audit selection, as it always has, largely on the basis of return characteristics. Like other compliance initiatives the IRS has launched in the past that “seemed to represent a fundamental change in the way the IRS thought about its mission,” the MSCP risks “not materializ[ing] into any fundamental change in the way that IRS [does] business.”<sup>35</sup>

### *The IRS Lags Years Behind Other Jurisdictions in Providing Taxpayer Services Designed to Enhance Compliance.*

In 2014, the IRS formed the Compliance Capabilities Initiative, led by senior leaders across various IRS divisions, which “seeks to enhance taxpayer experience and deliver transformative improvements to tax administration by 2019.”<sup>36</sup>

When implemented, the Initiative is expected to allow the IRS to better interact with taxpayers throughout their compliance lifetimes by taking into consideration individual characteristics. For example, a taxpayer who historically files returns and pays taxes timely might receive pre-filing notification of tax law changes that might apply to that taxpayer (*e.g.*, provisions of the Affordable Care Act). The taxpayer might also receive information that reflects transitions through life stages (*e.g.*, as retirement approaches). If this compliant taxpayer is audited (resulting in no change to his or her tax liability), the IRS could adjust its audit selection processes so taxpayers like this one are not also selected for audit in later years or later in the filing season.

32 Internal Revenue Service FY 2015 Budget Request, Congressional Budget Submission 187, available at [http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY\\_2015\\_CJ\\_Submission.pdf](http://cfo.fin.irs.gov/SPB/BudgetFormulation/FY%202015/FY_2015_CJ_Submission.pdf).

33 *Id.*

34 SB/SE response to TAS information request (Sept. 15, 2014). The referenced Compliance ConOps, or Compliance Concept of Operations, is the IRS’s vision of how it will implement its compliance programs. According to the Compliance ConOps draft, the IRS’s insight into taxpayer compliance will be based on its analysis of tax returns. W&I and SB/SE Compliance ConOps v2.2, July 31, 2014, on file with the National Taxpayer Advocate.

35 Adrienne Poulton, *Addressing Noncompliance at the Internal Revenue Service* 8, submitted to the National Commission on Restructuring the Internal Revenue Service, describing the evolution and demise of Compliance 2000, on file with TAS.

36 Compliance Capabilities Initiative, Draft Blueprint for the Vision 1 (June 19, 2014), on file with the National Taxpayer Advocate.

A taxpayer who is newly employed, with no history of return filing, might be treated differently. To ensure that this first-time filer does not become a nonfiler, the IRS might work with employers or other external partners to ensure they provide this “new hire” with information about filing and payment obligations, including a link to a withholding calculator. When the IRS receives third-party information returns for this taxpayer, it might send the taxpayer information about the requirement to file a return. If this taxpayer does not file by April 15, the IRS would intervene quickly and resolve the taxpayer’s case within the current tax year. The IRS would then remind this taxpayer to file in the following year.<sup>37</sup>

These initiatives are appropriate uses of tax return data. Chile is one jurisdiction that has had this type of taxpayer service in place for over a decade as a means of encouraging compliance.<sup>38</sup> Since the early 2000’s, Chilean taxpayers have been able to access their online tax accounts, view any third party reporting of their income or income tax withholding, and pay their income, value-added (VAT), and real estate taxes online.<sup>39</sup> Since 2008, business taxpayers in Chile have been able to create personal pages through the government website and receive information and published guidance pertinent to their specific lines of businesses, in real time as it is published.<sup>40</sup> The Chilean tax authority also provides taxpayer education through its Tax Education Portal, which includes material aimed at children and classroom tools teachers can use to explain basic tax concepts.<sup>41</sup>

### *The IRS Does Not Incorporate Existing Relevant Research Into its Audit Selection Processes.*

In 2013, the IRS developed the Individual Reporting Compliance Model (IRCM).<sup>42</sup> In a simulation experiment, the model estimated the direct and indirect effects of taxpayer audits.<sup>43</sup> However, the IRS does not view these research results as directly translatable into the development of audit selection formulas or methods, in part because “the state of knowledge about taxpayer behavior is limited.”<sup>44</sup> Moreover, according to the IRS, “[m]any of the variables (‘characteristics’ or ‘behaviors’) that would be associated with indirect effects would be taxpayer personal characteristics considered inappropriate to use for selecting particular returns for audit—assuming that data about these characteristics were actually available.”<sup>45</sup>

The National Taxpayer Advocate would be the first to condemn “audit profiling” on the basis of taxpayers’ unrelated personal characteristics, as opposed to audit selection based on research about what drives taxpayer compliance. However, the IRS’s obligation to respect taxpayers’ rights does not excuse it from developing compliance initiatives based on unbiased, applied research about taxpayer behavior.

37 The IRS would tailor its approach to other groups of taxpayers (e.g., victims of identity theft, or those who file returns but do not fully pay the tax) along these lines. Compliance Capabilities Initiative, Draft Blueprint for the Vision (June 19, 2014), on file with the National Taxpayer Advocate.

38 See Caroline Musalem, Commissioner’s Special Advisor For International Affairs And Cooperation, Chilean Internal Revenue Service, *Successful practices in the use of electronic means to improve compliance: the Chilean example*, available at <http://cstest.s4tp.org/wp-content/uploads/2010/10/15-musalem.pdf>.

39 See *id.* at 3.

40 See *id.* at 8, *Successful practices in the use of electronic means to improve compliance: the Chilean example*, available at <http://cstest.s4tp.org/wp-content/uploads/2010/10/15-musalem.pdf>.

41 See [www.siieduca.cl](http://www.siieduca.cl).

42 Kim Michael Bloomquist, IRS Office of Research, *Incorporating Indirect Effects in Audit Case Selection: An Agent-Based Approach* (June 2013), available at <http://research.web.irs.gov/compliance.htm>.

43 Of four audit strategies analyzed, the strategy with the highest combined direct and indirect effect on voluntary reporting compliance was one with a relatively high coverage rate of business audit classes and a minimum coverage of nonbusiness audit classes.

44 Additionally, the IRCM is a prototype representing a particular geographic area and is not a nationwide model. SB/SE response to TAS information request (Sept. 15, 2014).

45 SB/SE response to TAS information request (Sept. 15, 2014).

Other research on the earned income tax credit provides insight about the causes of compliance and taxpayers' compliance behavior, and the National Taxpayer Advocate has made specific recommendations based in part on that research.<sup>46</sup> As part of a multi-year study to identify the major factors that drive taxpayer compliance, TAS has also recently researched the effects of audits on certain small business taxpayers' subsequent compliance.<sup>47</sup> The findings suggest that audits may minimally deter future noncompliance, on returns filed immediately after the audit, but this effect disappears within five years. Field and office audits may be more effective deterrents than correspondence audits, and audits that result in large assessments may be more effective in promoting future compliance. However, there may be a group of taxpayers for whom audits do not have a deterrent effect.<sup>48</sup> TAS is willing to work with the IRS to incorporate these research findings into an overall strategy.

*For Compliance Initiatives to Promote Future Compliance, They Must be Driven by Social Science Research and Tested Before Implementation.*

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**IRS audit selection processes should support the Taxpayer Bill of Rights (TBOR) by comprising part of an overall compliance strategy—one that will drive future compliance, not only by the taxpayer under audit, but also by other taxpayers in similar situations.**

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As discussed above, the IRS articulates its commitment to integrating research into its overall compliance strategy, and has advanced technology to do so, but is not actively seeking the data it needs.<sup>49</sup> Without the data social science research would yield, the IRS cannot consider return information in the light of other variables—such as whether a given population of taxpayers, taking into account its demographics and other factors, is likely to comply in the future in response to an audit or whether education and outreach would drive future compliance. The IRS's general approach to compliance will consist only of tactics and will not constitute a compliance strategy.

Other IRS initiatives have different hallmarks. For example, before launching the Payment Card Compliance Program, designed to address income underreporting by small businesses, the IRS adopted a “multi-year test, learn and build” approach.<sup>50</sup> The approach allows the IRS to test its matching program on a sample of taxpayers and adjust its practices in the light of initial experience with the program.<sup>51</sup>

46 Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 KAN. L. REV. 1145 (2003); *Internal Revenue Service Oversight: Hearing Before the H.R. Comm. on Appropriations Subcomm. on Financial Services and General Government*, 113th Cong. 42-47 (2014) (written testimony of Nina E. Olson, National Taxpayer Advocate), describing the IRS Tax Year 2006–2008 National Research Program Compliance Study (Feb. 12, 2014).

47 *Estimating the Impact of Audits on the Subsequent Reporting Compliance of Small Business Taxpayers: Preliminary Reports*, vol. 2, *infra*.

48 *Id.*

49 See, e.g., IRS Information Technology News, *CADE 2 & You: the implementation of the CADE 2 database* (Nov. 7, 2012) available at <http://mits.web.irs.gov/News/20121107HTLCADE2&You-DatabasImplementation.htm>, describing the IRS's relational database, Customer Account Data Engine (CADE) 2 as “the most complex database in the world.”

50 Consolidated W&I and SB/SE response to TAS information request (Sept. 15, 2014) (providing IRS Office of Compliance Analytics *Payment Card Program Pilot, Preliminary Year 1 Results Update* slide 2 (June 29, 2014)).

51 See Jaime Arora, *SB/SE Payment Card Reporting Program Still In Pilot Stage*, 2013 TNT 215-6 (Nov. 6, 2013), quoting the IRS Small Business/Self-Employed Division Commissioner inviting practitioners to send him any “horror stories” they had from the program; Letter from Sam Graves, Chairman, Committee on Small Business, to Faris Fink, Commissioner, IRS Small Business/Self-Employed Division (Aug. 9, 2013), describing concerns with the IRS “soft notice” (letter advising taxpayers they may have underreported their gross receipts) (on file with TAS); SB/SE Office of Compliance Analytics, *Payment Card Case Management Tech Demo Phase II* (Sept. 17, 2014), on file with the National Taxpayer Advocate.

### *Other Jurisdictions Have Adopted a More Comprehensive Approach to Tax Compliance.*

Practices of other tax authorities also provide useful insights, particularly with respect to the use of a broad approach to taxpayer characteristics and norms to identify the most effective compliance touch. For example, the United Kingdom's (UK) tax authority has an external research program, the Behavioural Evidence and Insight Team. In 2012, the team researched why small and medium sized businesses enter and operate in the hidden economy, identified six hidden economy "typologies," and provided insights about how to reach each group and advice on what messages to avoid for each group.<sup>52</sup> The team then presented four options for gathering additional information about participants in the hidden economy, such as surveys or samples.<sup>53</sup>

The UK's compliance strategy also includes "campaigns" directed at taxpayers in certain occupations where underreporting is known or suspected, with the objective of improving tax compliance generally and not just from evaders.<sup>54</sup> An electricians' campaign, for example, consisted of first surveying electricians about their views and attitudes about tax evasion. The electricians were then advised, through letters, radio spots,<sup>55</sup> trade media,<sup>56</sup> flyers,<sup>57</sup> and outdoor posters,<sup>58</sup> that they would be treated leniently if they came forward and disclosed previously unreported income. The disclosure period lasted from February through August of 2012, after which the tax authority targeted for audit those whom it suspected should have disclosed but who did not.<sup>59</sup> The campaign concluded with another survey to measure electricians' changes in attitudes towards tax evasion as a result of the campaign.

The UK also seeks to prevent tax noncompliance in ways that involve the tax authority only indirectly. For example, the Security Industry Authority (SIA), the organization responsible for regulating the private security industry in the UK, carries out a risk assessment of businesses that apply for a license.<sup>60</sup> The evaluation, intended "[t]o assess the overall risk your business represents to our regulatory objectives," includes tax compliance as a component of a separate risk category, "financial probity."<sup>61</sup> Once approved,

52 HM Revenue & Customs, Business Customer & Strategy, Behavioural Evidence & Insight Team *Understanding key problems for SMEs: Hidden Economy Levers, Ghosts and Moonlighters, Identifying effective levers to reduce entrants into, and encourage SMEs out of the Hidden Economy* (May 2012), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/344827/report208.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344827/report208.pdf).

53 HM Revenue & Customs, Business Customer & Strategy, Behavioural Evidence & Insight Team, *Hidden Economy: Quantitative Feasibility Study, Establishing effective research methods for future quantitative analysis of the Hidden Economy* (May 18, 2012), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/344826/report209.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344826/report209.pdf).

54 See, e.g., HM Revenue and Customs Research Report 260, *HMRC Electricians Tax Safe Plan Research Report* (Apr. 2013), available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/344773/report260.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344773/report260.pdf).

55 The radio script was: "SFX [sound effects]: The click of an electric switch. MVO [male voice over]: Us electricians can't afford to take chances with safety. There's a responsibility to do the job right, so our customers stay safe and so do we. This responsibility also applies to our tax. If we don't declare our earnings, we're running a risky business. Revenue and Customs want electricians to talk to them about undeclared income by May 15th. Or they'll come looking. So stay safe. Contact them before they contact you. Call HMRC [Her Majesty's Revenue and Customs] now on 0845 601 5041." *Id.*, at 55.

56 An ad placed in trade press, captioned "HMRC to pull the plug on electricians" explained how electricians could come forward and report previously undisclosed income, noting that "a low rate penalty charge will be made to any electricians who complete a notification form, but this is better than facing a possible criminal investigation." *Id.*

57 A flyer directed at electricians described a previous successful campaign directed at plumbers and announced, "We are now looking closely at electricians and we are using a number of different sources to help us target those who have not declared their full income. We are building on the same methods that we used for the plumbers' campaign—because they work." *Id.*, at 54.

58 An outdoor sandwich board featured a picture of a multimeter (a device electricians use to measure various characteristics of an electrical circuit) captioned "Electricians you have until 15 May to check your tax affairs are in order" with an explanation of how to come forward, by email, text, or phone, and report previously unreported income. *Id.*, at 53.

59 By November 2012, the campaign had raised more than 2.2 million pounds. *Id.*, at 12.

60 Security Industry Authority (SIA), available at <http://www.sia.homeoffice.gov.uk/Pages/home.aspx>

61 SIA, Risk Assessments, available at <http://www.sia.homeoffice.gov.uk/Pages/business-risk.aspx>.

“a business license holder must provide a yearly return as and when it is due” or risk suspension of or withdrawal of the license.<sup>62</sup>

## CONCLUSION

Sixteen years after the National Commission for Restructuring the IRS directed the IRS to base its audit selection process on research—which for tax administration today means applied social science research about taxpayer behavior—the IRS’s approach to compliance, including audit selection, continues to be driven primarily by tax return data. Tax authorities in other jurisdictions rely on social science research in determining how to promote taxpayer compliance, and the service they provide to taxpayers as part of an overall compliance strategy is more advanced than at the IRS. The IRS is aware that it should adopt a holistic approach to compliance, and articulates its commitment to doing so, but has not wholeheartedly embraced that commitment.

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62 SIA, Approval Conditions, *available at* <http://www.sia.homeoffice.gov.uk/Pages/business-conditions.aspx>.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Adopt “increasing voluntary compliance” as the primary measure for evaluating both enforcement and taxpayer service initiatives.
2. Not only incorporate applied and behavioral research into all of its compliance initiatives, but also fund or activate compliance initiatives only after adopting an integrated strategy that articulates how the IRS will:
  - a. Use education, outreach, partners, assistance, non-invasive compliance touches, and enforcement touches to increase compliance;
  - b. Test the initiative before full deployment, and use tests or pilots to project the effect on future compliance;
  - c. Measure the initiative’s success, including conducting surveys and focus groups both before and after the initiative; and
  - d. Adjust its overall compliance plan in the light of continuing research findings and trends.

**MSP  
#12****ACCESS TO THE IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division  
 Heather C. Maloy, Commissioner, Large Business and International Division  
 Sunita B. Lough, Commissioner, Tax Exempt and Government Entities Division  
 Kirsten B. Wielobob, Chief, Office of Appeals  
 Richard Weber, Chief, Criminal Investigation

**DEFINITION OF PROBLEM**

Taxpayers very often face difficulty in reaching the right person at the IRS in order to resolve their problems. The IRS Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to make itself accessible to taxpayers, specifically by phone. Section 3709 of RRA 98 mandates that the IRS place the addresses and telephone numbers for local offices in local phone directories across the country.<sup>1</sup> However, even though the IRS largely meets this requirement, calling the local offices does little good. The IRS does not answer the phone at local offices and has even removed the option it once provided for taxpayers, including the elderly and disabled, to leave a message.<sup>2</sup>

Another provision of RRA 98 requires the IRS to provide taxpayers with an option to talk to an employee on IRS helplines in “appropriate circumstances” and direct a taxpayer’s questions to other IRS employees who can help.<sup>3</sup> Although the IRS does transfer callers on its main toll free phone line to live assistants in some circumstances, it does not offer taxpayers the option of choosing to speak to a live person. The IRS has failed to engage in forward thinking or embrace current technology that would allow it to comply with the intent (and not just the letter) of the RRA 98 provisions—ensuring taxpayers can reach the person at the IRS who can answer their questions or help with their problem.<sup>4</sup> Taxpayers have the *right to quality service*—to receive prompt, courteous, and professional assistance and to speak to a supervisor about inadequate service, and the right to be informed, meaning they have a right to know what they need to do to comply with the tax laws.<sup>5</sup> When taxpayers cannot speak to a person at their local

- 1 Section 3709 of the IRS Restructuring and Reform Act of 1998 (RRA 98), 105 Pub. L. No. 206, 112 Stat. 779 provides: “The Secretary of the Treasury or the Secretary’s delegate shall, as soon as practicable, provide that the local telephone numbers and addresses of Internal Revenue Service offices located in any particular area be listed in a telephone book for that area.”
- 2 The listings for local IRS offices in the phonebooks provide the number for the local Taxpayer Assistance Center (TAC). Using the numbers from local phonebooks, on July 31 and August 1, 2014, TAS called a sample of 80 TACs around the country during normal business hours and found that none allowed the taxpayer to leave a message or speak to a live person. According to the IRS, taxpayers have never had the ability to speak to a live person when calling these phone numbers. See IRS response to TAS information request (Sept. 19, 2014).
- 3 RRA 98 § 3705(d), 105 Pub. L. No. 206, 112 Stat. 777. “The Secretary of the Treasury or the Secretary’s delegate shall provide, in appropriate circumstances, on telephone helplines of the Internal Revenue Service an option for any taxpayer to talk to an Internal Revenue Service employee during normal business hours. The person shall direct phone questions of the taxpayer to other Internal Revenue Service personnel who can provide assistance to the taxpayer.”
- 4 The National Taxpayer Advocate has repeatedly raised the issue of the difficulty taxpayers have in navigating the IRS. See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 114-25 (Most Serious Problem: *Navigating the IRS*).
- 5 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

IRS office, or find the right person to talk to, their *right to quality service* and *right to be informed* are compromised.

## ANALYSIS OF PROBLEM

### Legislative History of RRA 98

Section 3709 of RRA 98 requires the IRS to publish the phone numbers and addresses of local IRS offices in local phone books.<sup>6</sup> The RRA 98 Senate Committee Report reflects the intent that “every taxpayer should have convenient access to the IRS.”<sup>7</sup> A key part of convenient access is the ability for taxpayers to find and contact the right person to solve their tax matters. Speaking about RRA 98, Senator Domenici explained, “Taxpayers are often left with no option but to contact my office asking for help in simply identifying who they should talk to at the IRS to settle their tax matter. The caseworkers are experts, but it would take them two days to track down the right IRS office so that the constituent could try and solve their problem.”<sup>8</sup>

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Only some of the phonebooks sampled by TAS provided a nationwide phone number for the IRS Office of Appeals, and this turned out to be the number for a private business.

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Section 3705(d) of RRA 98 requires the IRS to not only make a live person available on helplines in appropriate circumstances, but for that person to direct the taxpayer to another employee who can help the taxpayer resolve problems.<sup>9</sup> Senator Domenici explained this provision requires that “automated phone lines include the option to talk to a real, knowledgeable person who can answer the taxpayers’ questions. This would be an option in addition to merely listening to a recorded message.”<sup>10</sup>

### IRS Implementation of Sections 3709 and 3705(d)

When implementing Section 3709 in the years following RRA 98, the IRS created a template to update telephone directories with the numbers and addresses for local Taxpayer Assistance Center (TAC) offices and sent it to the phone companies.<sup>11</sup> In 2001, the IRS determined the standard services to be provided on the TAC phone numbers and developed message scripts and procedures for returning calls.<sup>12</sup> In 2003, the IRS established a quarterly certification process to ensure the accuracy of the published phone numbers.<sup>13</sup> When the IRS initially implemented RRA 98 § 3709, it only required each local office to

6 Section 3709 of RRA 98, 105 Pub. L. No. 206, 112 Stat. 779, provides: “The Secretary of the Treasury or the Secretary’s delegate shall, as soon as practicable, provide that the local telephone numbers and addresses of Internal Revenue Service offices located in any particular area be listed in a telephone book for that area.”

7 S. REP. NO. 105-174, at 106 (1998).

8 144 CONG. REC. S 4473 (daily ed. May 7, 1998) (statement of Sen. Domenici).

9 RRA 98 § 3705(d), 105 Pub. L. No. 206, 112 Stat. 777. “The Secretary of the Treasury or the Secretary’s delegate shall provide, in appropriate circumstances, on telephone helplines of the Internal Revenue Service an option for any taxpayer to talk to an Internal Revenue Service employee during normal business hours. The person shall direct phone questions of the taxpayer to other Internal Revenue Service personnel who can provide assistance to the taxpayer.”

10 144 CONG. REC. S4473 (daily ed. May 7, 1998) (statement of Sen. Domenici).

11 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-12857, AT-2009-12858 (retrieved May 28, 2014).

12 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-12866, AT-2009-12867 (retrieved May 28, 2014).

13 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-12874 (retrieved May 28, 2014).

have “a local telephone line with a mailbox capable of playing a generic script, taking incoming messages, and remote message retrieval.”<sup>14</sup>

When taxpayers were allowed to leave messages, the IRS required all calls to be “returned within two business days regardless of the issue even if just to provide the taxpayer with the appropriate toll-free number to access in order to answer a technical or account related question.”<sup>15</sup> However, in early 2013 the IRS removed the option for any taxpayer to leave a message, including the elderly and disabled.<sup>16</sup> Currently, the message on 3709 lines instructs elderly or disabled taxpayers to email the IRS to make an appointment.<sup>17</sup> During the 2014 filing season, the IRS received 212 such emails from elderly or disabled taxpayers. The IRS has no way of knowing how many elderly or disabled taxpayers called to make an appointment in prior years because it did not keep records of the number of messages received from elderly or disabled taxpayers during the 2012 and 2013 filing seasons.<sup>18</sup>

To implement Section 3705(d), the IRS made only a few changes. According to the IRS’s Legislative Analysis, Tracking and Implementation Services (LATIS) the IRS only had three action items related to implementing RRA 98 § 3705(d): revising the IRM to “provide Spanish Telephone Helplines in addition to helpline options enabling the taxpayer to speak to a live assistor” and providing an option for a taxpayer to speak to a live person on the Forms-Only Toll-Free line and Teletax line.<sup>19</sup> These efforts, while limited, did bring the IRS closer to compliance with section 3705(d).

### The Phone Numbers Provided in Local Phone Books Fall Short of the Level of IRS Access Intended by Congress.

TAS found the IRS has been largely successful in listing phone numbers for local offices in local phone books nationwide.<sup>20</sup> However, these numbers are not helpful to taxpayers. The phone books only list the main line for each local office and do not provide numbers for specific functions such as the local Appeals, Examination, or Collection office.<sup>21</sup> While the phone books do list a few nationwide toll-free numbers, they do not give the taxpayer the number to call if he or she needs to reach a specific person or department. If a taxpayer is experiencing a problem with part of the IRS, for example, having trouble with an Appeals Officer assigned to his or her case, contacting the local TAC—assuming someone would answer

14 Memorandum from Jeff Cooper, Director Telecommunications to Dave Gaugler, Director, Information Systems Field Operations, IRS (Sept. 19, 2001) (on file with TAS).

15 IRM 21.3.4.3.3.1.1, *Procedures for Taxpayer Assistance Centers* (Apr. 26, 2012).

16 The ability to leave a voice message was ended for all taxpayers and all TACs on April 12, 2013. See IRS response to TAS research request (Sept. 19, 2014).

17 See IRS response to TAS research request (Sept. 19, 2014). The message advises: “If you are disabled or elderly and require special accommodations for service, please email us at...” See IRM Exhibit 1.4.11-1 (Aug. 15, 2014). According to the IRM, all email messages sent to the email address stated on the 3709 line will be returned within three business days, regardless of the issue. See IRM 21.3.4.3.2.1.1, *Procedures for Taxpayer Assistance Centers*, (Feb. 12, 2014). Under the prior policy, callers who left a message on the 3709 lines would be called back within two business days to arrange an appointment. See IRM 21.3.4.3.3, *3709 Line and Assisting Taxpayers with Disabilities* (Oct. 1, 2009).

18 See IRS response to TAS research request (Sept. 19, 2014).

19 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-13275, AT-2009-13314 (retrieved May 28, 2014). The IRS uses LATIS to track all provisions, actions, and status of enacted legislation that impacts the Service. The Action Plan lists Action Items and is used to record and track relevant contacts and activities as they occur, covering the time frame from passage of the legislation to full implementation.

20 TAS conducted a convenience survey of 20 phone books and found that all included numbers for local TAC offices.

21 In addition to the main numbers for the local IRS offices, the phone books surveyed also included the following nationwide, toll-free numbers for the IRS: Need a Tax Form; Checking on a Refund; 24-Hour Recorded Tax Help; Federal Tax Questions; TDD-TTY Telephone Service; Report Tax Fraud Violations; National Taxpayer Advocate; Taxpayer Advocacy Panel; Tax Exempt-Government Entities; Appeals; and Citizens Advocacy Panel. The Citizen Advocacy Panel is no longer in existence; it was replaced in 2002 by the Taxpayer Advocacy Panel.

...not even elderly or disabled taxpayers, who are less likely to have access to the Internet and email, can leave a message on these lines.

(which is currently not the case)—would do no good. The taxpayer would need the number for the local Appeals office. Only some of the phonebooks sampled by TAS provided a nationwide phone number for Appeals, and this turned out to be the number for a private business.<sup>22</sup> The Office of Appeals has an Appeals Account Resolution Specialist phone line, which callers can use to find out if their cases have been assigned to an Appeals employee and how to contact that employee.<sup>23</sup> However, this number is not a toll-free number, it was not listed in local phone books surveyed by TAS, and was difficult to locate.<sup>24</sup>

Another reason the phone book listings are not helpful is that the phone lines for local offices, known as “3709 lines,” do not help taxpayers reach the IRS because they are not answered by a live person. As explained above, not even elderly or disabled taxpayers, who are less likely to have access to the Internet and email, can leave a message on these lines. Demographic research data show only 57 percent of adults over age 65 use the Internet compared to 87 percent of all adults.<sup>25</sup> According to 2010 Census data, only 41 percent of those with a non-severe disability use the Internet and only 22 percent of those with a severe disability age 65 and older use the Internet.<sup>26</sup> For those without Internet access, the only viable ways to reach the IRS are by phone, or in person.<sup>27</sup>

TAS surveyed a statistically valid sample of 80 TACs in July 2014 and found that all 80 had the same recording of a generic script.<sup>28</sup> The recordings do not state all services the TACs provide, and instead instruct taxpayers to access IRS.gov for a full list of available services.<sup>29</sup> In a 2011 employee training, the IRS identified the purpose of 3709 lines: to “[a]dvise Taxpayer [of] the options available to obtain assistance other than making an appointment.”<sup>30</sup> However, the only option the message provides is for the taxpayer to find information on IRS.gov, or email the IRS if the taxpayer is elderly or disabled.<sup>31</sup> The message does not even offer another number for the taxpayer to call, let alone the ability for the taxpayer to be transferred to another number or speak with a live assistor.

TAS twice inquired of the IRS in a formal information request whether it considers the 3709 lines to be “helplines” for the purpose of § 3705(d) of RRA 98, which would require them to have an option to speak with a live person. TAS also asked what lines the IRS does consider to be helplines. Twice, the IRS

22 At the time of this report, multiple phone books listed a number for Appeals Nationwide that belonged to a company offering non-IRS related services.

23 See IRS, *What Can You Expect from Appeals?*, available at <http://www.irs.gov/Individuals/What-Can-You-Expect-from-Appeals%3F> (last updated Nov. 5, 2014). See IRM 8.1.9.4, *Appeals Customer Service Telephone Line* (Dec. 17, 2013).

24 As of December 18, 2014, TAS found only one webpage on the IRS.gov website that listed this number. See IRS, *What Can You Expect from Appeals?*, available at <http://www.irs.gov/Individuals/What-Can-You-Expect-from-Appeals%3F> (last updated Nov. 5, 2014).

25 Pew Research Center, *Internet User Demographics* (2014), available at <http://www.pewinternet.org/data-trend/internet-use/latest-stats/>.

26 U.S. Census, *Reported Computer and Internet Access, by Selected Individual Characteristics: 2010, Table 4*, available at <http://www.census.gov/hhes/computer/publications/2010.html> (last visited on Nov. 24, 2014).

27 Reaching the IRS in person is becoming increasingly difficult due to the degradation of taxpayer service at TACs. See National Taxpayer Advocate FY 2015 Objectives Report to Congress 135 (Review of the 2014 Filing Season).

28 TAS randomly sampled the population of 377 TACS at a 90 percent confidence with a precision of five percent assuming an estimated population percentage with the characteristic at 10 percent. The 10 percent estimated population percentage with the characteristic was determined by conducting a five percent random sample of the population that showed that no TAC varied from the generic script.

29 IRM Exhibit 1.4.11-1 (Aug. 15, 2014).

30 IRS, FY 2011 Field Assistance Continuing Practical Education, 3709 Telephone Line.

31 IRM Exhibit 1.4.11-1 (Aug. 15, 2014).

declined to answer these questions.<sup>32</sup> Without defining what phone lines are helplines, the IRS is avoiding its responsibility to implement § 3705(d) of RRA 98. Even if the IRS does not consider the 3709 lines to be helplines, and thus technically meeting the requirements of §§ 3709 and 3705(d) of RRA 98, it has failed to meet the purpose of the sections, which is to provide taxpayers convenient access to the IRS to resolve their tax matters.

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**TAS twice inquired of the IRS in a formal information request whether it considers the 3709 lines to be “helplines” for the purpose of section 3705(d) of the IRS Restructuring and Reform Act, which would require them to have an option to speak with a live person. TAS also asked what lines the IRS does consider to be helplines. Twice, the IRS declined to answer these questions.**

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### **The Main Toll-Free IRS Phone Lines Do Not Help Taxpayers Reach the Right Person.**

One result of the IRS’s reorganization as part of RRA 98, when it went from being structured geographically to being organized based on the type of taxpayer (*e.g.*, small business, tax-exempt, etc.),<sup>33</sup> is that taxpayers’ issues are often not handled by their local offices but instead by employees in centralized, remote locations. In addition to publishing the numbers for the 3709 lines, the local phone books often include the IRS’s main toll-free number, as well as some other primary numbers, such as the main nationwide Tax Exempt/Government Entities phone number and the refund hotline.<sup>34</sup> However, these numbers do not help taxpayers reach the right person. If the taxpayer is calling for one of the most common reasons to reach the IRS—to check on a refund—then the taxpayer has a dedicated help line.<sup>35</sup> Yet, if a taxpayer is calling about a specific tax or IRS issue, he or she must navigate an extended phone tree. For example, if a taxpayer wants to talk to someone at the IRS about applying for an offer in compromise (OIC), the taxpayer must go through a number of prompts to reach a customer service representative, and if he or she is successful in reaching a person, that person may not even have expertise in offers. Taxpayers may sit on hold for an extended period prior to reaching a live assistant.<sup>36</sup> TAS called the main toll-free line at approximately 6:00 p.m. Eastern Standard Time on November 10, 2014, to ascertain how long it would take to reach a customer service representative (CSR) and whether the CSR could then transfer the caller to an employee in the centralized offer in compromise unit, who would be able assist the taxpayer. Unfortunately, the caller never made it that far. The following details the phone journey:

32 IRS responses to TAS research requests (Sept 19, 2014 and Oct. 29, 2014).

33 See Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of a Cross-functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

34 In addition to the main numbers for the local IRS offices, the phone books surveyed also included the following nationwide, toll-free numbers for the IRS: Need a Tax Form; Checking on a Refund; 24-Hour Recorded Tax Help; Federal Tax Questions; TDD-TTY Telephone Service; Report Tax Fraud Violations; National Taxpayer Advocate; Taxpayer Advocacy Panel; Tax Exempt-Government Entities; Appeals; and Citizens Advocacy Panel.

35 See IRS, Basic Tools for Tax Professionals, available at <http://www.irs.gov/Tax-Professionals/Basic-Tools-for-Tax-Professionals> (last visited Nov. 24, 2014).

36 In FY 2014 the IRS received about 86.2 million telephone calls. Only 64.4 percent of calls seeking to reach a customer service representative got through, and those callers had to wait an average of 19.6 minutes on hold. See IRS, *Enterprise Snapshot Week Ending: September 30, 2014* (Oct. 16, 2014).

TAS called the main toll-free line at approximately 6 p.m. EST on November 10, 2014, acting as a taxpayer who has questions about filing a request for an offer in compromise, to ascertain how long it would take to reach a customer service representative (CSR) and whether the CSR could then transfer the caller to an employee in the centralized offer in compromise unit, who would be able to assist the taxpayer.

 **Taxpayer dials 1-800-829-1040**

Welcome to the Internal Revenue Service.  
You can also visit us at [www.irs.gov](http://www.irs.gov).

- 1 To continue in English, press 1.
- 2 Para continuar en Español, oprima dos.

 **Taxpayer presses 1**

Due to high demand, you may experience longer than usual wait times. If you do not need immediate assistance, please call back on Wednesday or Thursday. You may also check the status of your federal income tax refund by visiting us at [www.irs.gov](http://www.irs.gov).

- 1 For questions about your refund, or to check the status of your Form 1040X, Amended Tax Return, press 1.
- 2 For questions about your personal income taxes, press 2.
- 3 For business taxes, press 3.
- 4 To hear general information about the health care law, including how it may affect individuals, families, and employers, press 4.
- 5 For questions about your personal or business taxes as it relates to health care, press 5.
- 9 To repeat this menu, press 9.

 **Taxpayer presses 2**

- 7 If you are filing your return electronically, and you do not have your prior year AGI or your prior year self-selected Pin, press 7.
- 1 For questions about a form you have already submitted, your tax history, or payment, press 1.
- 2 For questions about tax rules, or for help filing a form, press 2.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

At this point the taxpayer may be confused as none of the prompts address his issue. He has questions about filing a request for an offer in compromise, but none of these prompts address his need.

 **Taxpayer presses 1**

- 1 For questions about your refund, or to check the status of your Form 1040X, Amended Tax Return, press 1.
- 2 If you need an account or tax return transcript, press 2.
- 3 If you only need your prior year's AGI, press 3.
- 4 For all other questions about your tax history or payment, press 4.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

The taxpayer is further confused by prompt one, because the earlier announcement already asked the taxpayer if he had questions about his refund and amended tax return, and he did not select that option.

 **Taxpayer presses 4**

- 1 To find out how to correct a form you already filed, press 1.
- 2 For all other questions about your tax history or payment, press 2.
- 9 To repeat this menu, press 9.
- 6 To return to the previous menu, press 6.

 **Taxpayer presses 2**

Please wait.  
To access your account information, please enter the Social Security number or employer identification number for which you are calling.

 **Taxpayer enters 9-digit Social Security number**



This example demonstrates multiple shortcomings with the IRS's automated system. The prompts and announcements are confusing to taxpayers, whose issues may not be covered by the limited options the system provides. Nowhere during the six minute journey<sup>37</sup> detailed above did the caller have the opportunity to talk to a live person, which violates RRA 98 § 3705(d).<sup>38</sup> Clearly the IRS's main toll-free phone line is one of the "automated phone lines" that Senator Domenici was talking about when he was explaining section 3705(d).<sup>39</sup> Although the IRS provides, "In some cases, if customers are unable to navigate the menu, the system will route the call to a live assistor," it is the IRS making this decision without giving taxpayers the option to choose to speak to a live person.

Furthermore, even if the taxpayer in the above example reached a live person, that person may not have been able to help the taxpayer with her offer. The IRS uses a Telephone Transfer Guide to provide customer service representatives with the correct application for transferring a call, which provides 40 options for calls in English and 24 for calls in Spanish.<sup>40</sup> The general policy is "All employees, except those assigned to Default Screener, will answer all procedural inquiries for which they have been trained."<sup>41</sup> If a taxpayer calls to speak to an employee about qualifying for an OIC, the Telephone Transfer Guide provides a specific application for the call to be transferred to. However, the taxpayer may not reach the OIC unit and instead, the call goes to an assistor trained to use the Individual Master File Balance Due Application.<sup>42</sup> This application is used for 22 other types of calls according to the Telephone Transfer Guide.<sup>43</sup> While it is helpful for the taxpayer if the assistor can access his or her account and answer basic questions about applying for an offer,<sup>44</sup> the taxpayer may want to talk to an employee within the OIC unit and have trouble getting to that person.<sup>45</sup>

In some situations, the caller is transferred to a specific office or unit, but not the right one. An example involves a taxpayer whose OIC was accepted and who has made all of her payments, but whose lien has not been released or withdrawn. This taxpayer lost her OIC acceptance letter when she moved, so she looks to the IRS website for the number to call. She calls the main toll-free number, and after going through a number of prompts, she speaks to an assistor who transfers her to the phone line for the Lien Unit. However, the Lien Unit then tells her she must instead contact back end processing to make sure it

37 The call conducted by TAS lasted approximately six minutes and nine seconds.

38 In its response to TAS, the IRS acknowledged, "The 1040 line does not advertise an option to be 'transferred to a live person'." It further stated "By offering the option of a live person to customers when it is unnecessary and an automated application is available, we would undermine our ability to effectively serve those customers who truly need live assistance."

39 See earlier discussion, Legislative History of RRA 98.

40 See *IRS Telephone Transfer Guide* (updated Oct. 30, 2014). <http://serp.enterprise.irs.gov/TTGuide/TTGuide.jsp>.

41 IRS Telephone Transfer Guide (TTG) Telephone Transfer Policy, <http://serp.enterprise.irs.gov/databases/who-where.dr/ttg.dr/nav/transfer-policy.htm>.

42 See *IRS Telephone Transfer Guide* (TTG), Accounts Management Aspect Application Information <http://serp.enterprise.irs.gov/databases/who-where.dr/ttg.dr/nav/titles.htm>

43 For example, this application is also used for bankruptcy or insolvency, notice of intent to levy, and lien release. See *IRS Telephone Transfer Guide* (updated July 31, 2014).

44 IRM 21.3.12.6.3.1, *Taxpayer is Requesting an OIC*, (Oct. 1, 2014) provides customer service representatives with limited information about submitting an offer and instructions for sending the caller Form 656-B, *Offer in Compromise Booklet*. IRM 21.3.12.6.3.2, *Taxpayer Requests Help in Preparing Form 656* (Oct. 1, 2014) advises: "The Form 656-B, Offer in Compromise Booklet, contains information and Forms that the taxpayer needs in order to prepare a complete and accurate Offer in Compromise. If taxpayer needs further clarification of the tax law or which forms to use have them contact the nearest IRS Taxpayer Assistance Center."

45 If the taxpayer is inquiring about the status of an offer, and it has been 45 days or more since the taxpayer submitted the offer form, the IRM advises the employee to prepare a written referral and fax it to the Centralized Offer in Compromise Campus (COIC), and advise the taxpayer that a call-back should be received within the next 5 business days. The IRM also provides the employee with the option of providing the taxpayer the appropriate COIC toll free phone number, stating that if the taxpayer insists on contacting the COIC themselves, the written referral is not necessary. IRM 21.3.12.6.3.3, *Taxpayer Is Inquiring about the Status of an OIC Application* (Oct. 1, 2013).

shows that her offer is fully paid. This process could have been avoided if the IRS had a published phone directory with a centralized OIC number.

### The IRS Needs to Adapt by Applying the RRA 98 Requirements in Light of Changing Technology, Taxpayer Demographics, and its Business Model.

Since 1998, the IRS has changed in terms of business organization and technology, serving diverse taxpayer populations.<sup>46</sup> When the IRS was implementing RRA 98 in 2001, some phone lines could not transfer calls, and instead the assistor had to provide the taxpayer with a phone number to call back. In the current environment, the IRS should be forward-thinking in creating convenient ways for taxpayers to access the IRS to resolve their tax matters. The IRS could achieve this by creating a directory of departments that the public could access, or by establishing a call routing system similar to 311 lines used by municipalities, states, and foreign countries.

The IRS already has a public directory that it distributes to practitioners, which provides them with the phone numbers of key offices in their states.<sup>47</sup> For example, a tax professional in Connecticut dealing with a lien can use the state directory to find the national number for lien releases as well as the New England Group Advisory Manager; or a practitioner in Georgia dealing with field collection can find the numbers for the Area Director of Gulf States, the Territory Manager for Atlanta, the Territory Manager for South Georgia and the Territory Manager for the Offer in Compromise unit. The IRS should consider creating a similar directory for the public. When asked why the IRS does not provide a public directory for all taxpayers, the IRS stated, “Taxpayers are better served if contacts are made in accordance with Publication 910, *IRS Guide To Free Tax Services*, and the web pages mentioned above verses [sic] calling individual employees who may or may not have the expertise to address their concerns.”<sup>48</sup> However,

this response ignores a persistent problem with requiring most taxpayer calls to be handled by a CSR who handles a range of issues—the CSR speaking to the taxpayer may not have the expertise in the specific issue to assist the taxpayer. Furthermore, this response is illogical because if the IRS published a directory with a phone number for local Appeals personnel or OIC personnel, and a taxpayer were to call regarding one of these issues, in theory the local Appeals or OIC employee should be very knowledgeable about the issue in which he or she specializes.

Another way for the IRS to make itself accessible would be to adopt a system similar to a 311 routing system. Many municipalities in the United States have moved to 311 programs, which consolidate numerous call centers and phone numbers so a user only needs to call one number and can be routed to the

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Nowhere during the six minute “journey” through the IRS phone system did the caller have the opportunity to talk to a live person, which violates § 3705(d) of the IRS Restructuring and Reform Act.

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46 See National Taxpayer Advocate 2011 Annual Report to Congress, Vol. 2 36-44 (Research Study: *From Tax Collector to Fiscal Automaton: Demographic History of Federal Income Tax Administration, 1913-2011*). See also Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of a Cross-functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance, supra*.

47 See SB/SE, IRS Telephone Directory for Practitioners, available at <http://sbse.web.irs.gov/CL2/sl/PracDir/default.aspx> (last visited Sept. 2, 2014).

48 IRS response to TAS research request (Sept. 24, 2014).

correct agency, department, or office.<sup>49</sup> When a caller dials 311 in New York City, the caller first talks to the Interactive Voice Response System (IVR), which is recognized to be a “thin layer.” Approximately 50 percent of total calls are addressed by IVR.<sup>50</sup> Calls that are not addressed are transferred to a call center representative (CCR).<sup>51</sup> Using keywords, the CCR searches a knowledge database containing over 7,000 pieces of information about various agency services as well as other related organizations to identify the caller’s need.<sup>52</sup> Then, the CCR can:

- Provide the information requested (this occurs 40 percent of the time);
- Process a service request (24 percent of the time); or
- Transfer the call to an external agency (26 percent of the time).<sup>53</sup>

The IRS could use this system as a model, using intelligent automation to answer a significant number of calls and a combination of live interaction and an in-depth information database to address the remaining calls. The IRS’s current system does not allow the taxpayer a “one-stop shop” similar to the 311 program. If a taxpayer calls the IRS to discuss a collection due process (CDP) hearing, and there is an open control for a CDP hearing, the IRM instructs the employee *not to transfer the call* to the CDP coordinator, but instead to refer the call information to the Automated Collection System CDP coordinator, and fax an Inquiry Referral form to the Automated Collection System or CDP site that has jurisdiction over the account.<sup>54</sup> The CSR is then instructed to inform the taxpayer on the phone that someone will contact him or her in five business days.<sup>55</sup> If the IRS used a 311 system, the caller could immediately be transferred to the CDP unit where he could ask a collection employee about his or her hearing.

## CONCLUSION

The purpose behind the RRA 98 provisions regarding phones was to create ways for taxpayers to quickly and easily communicate with the right IRS employees. Publishing the phone numbers of local offices where phones are not answered and taxpayers cannot even leave a message does not make the IRS accessible. The IRS should proactively use technology to meet the needs and preferences of taxpayers so they can seamlessly find the right person to resolve their tax issues.

49 When a caller dials 311 in Prince George’s County Maryland, the caller receives a welcome message and is advised if this is an emergency call 911, for bulky trash please press 1. A Spanish language option is offered and then all other callers are asked to stay on the line for the next available person. The Maryland service does not provide a timeframe for how long a caller will be on hold, but when tested by TAS the wait time was 1 minute 15 seconds when the service was called at noon on a Monday and 2 minutes 5 seconds when tried on a Wednesday. The service hours are comparable to the IRS and are Monday–Friday from 7:00 am–7:00 pm, and 24 hours online.

50 ISPRAT, *Lessons for D115? A Review of 311 in New York City*, 7-8, available at [http://isprat.net/fileadmin/downloads/pdfs/ISPRAT\\_Projekt\\_Report\\_311\\_115\\_finales\\_Dokument.pdf](http://isprat.net/fileadmin/downloads/pdfs/ISPRAT_Projekt_Report_311_115_finales_Dokument.pdf) (last visited on Nov. 24, 2014).

51 ISPRAT, *Lessons for D115? A Review of 311 in New York City*, 8, available at [http://isprat.net/fileadmin/downloads/pdfs/ISPRAT\\_Projekt\\_Report\\_311\\_115\\_finales\\_Dokument.pdf](http://isprat.net/fileadmin/downloads/pdfs/ISPRAT_Projekt_Report_311_115_finales_Dokument.pdf).

52 New York City Independent Budget Office, *Fiscal Brief, 311 Customer Service Center: More Calls and a Growing Budget* (Apr. 2008), available at <http://www.ibo.nyc.ny.us/iboreports/311Apr08.pdf>.

53 ISPRAT, *Lessons for D115? A Review of 311 in New York City*, 9-10, available at [http://isprat.net/fileadmin/downloads/pdfs/ISPRAT\\_Projekt\\_Report\\_311\\_115\\_finales\\_Dokument.pdf](http://isprat.net/fileadmin/downloads/pdfs/ISPRAT_Projekt_Report_311_115_finales_Dokument.pdf).

54 See IRM 21.3.12.6.7.3.2, *Collection Due Process* (Oct. 17, 2011). IRM 21.3.5 (Oct. 1, 2014) provides general guidance about when to create a referral to another office, campus, or function.

55 See IRM 21.3.12.6.7.3.2, *Collection Due Process* (Oct. 17, 2011).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Provide an option for taxpayers calling the local TAC lines to speak to a live person or be transferred to another part of the IRS.
2. Provide a phone line for elderly or disabled taxpayers to call to make an appointment at a TAC, including messaging and callback service, and establish and publicize timeframes within which callbacks must occur.
3. Make the IRS Telephone Directory for Practitioners or a similar directory available to the public.
4. Institute a system similar to a 311 system where a taxpayer can be transferred by an operator to the specific office within the IRS that handles his or her issue or case.

**MSP  
#13****CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers****RESPONSIBLE OFFICIALS**

Karen Schiller, Commissioner, Small Business/Self-Employed Division  
Debra Holland, Commissioner, Wage and Investment Division

**DEFINITION OF PROBLEM**

In 1998, Congress directed that the IRS develop a procedure “to the extent practicable and if advantageous to the taxpayer” to assign one IRS employee to handle a taxpayer’s matter until it is closed.<sup>1</sup> Some IRS functions provide one employee to each case, while other IRS units have overlooked or ignored this mandate. For instance, Field Collection employees are reminded to provide their title, last name, and employee identification number during initial contact with a taxpayer.<sup>2</sup> Yet other IRS programs that involve lengthy interaction with taxpayers, such as Correspondence Examination, do not have a system for assigning cases to one employee.<sup>3</sup>

- 1 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206 § 3705(b), 112 Stat. 685, 777 (1998). See also Most Serious Problem: *AUDIT NOTICES: The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*, *infra*.
- 2 IRM 5.1.10.3(7), *Initial Contact*, (June 7, 2013). The collection process is not ideal, however. By the time an account makes it to assignment in Field Collection, it has potentially gone through a lengthy assessment and collection process. For instance, it may have spent some time in the Queue. For information on the IRS’s reliance on the Queue, see National Taxpayer Advocate 2012 Annual Report to Congress 358-380 (Most Serious Problem: *The Diminishing Role of the Revenue Officer Has Been Detrimental to the Overall Effectiveness of IRS Collection Operations*).
- 3 IRS response to a TAS information request (Sept. 5, 2014). Correspondence exam often sends notices that list the department manager as a general contact or do not contain any contact information. See National Taxpayer Advocate 2011 Annual Report to Congress, Vol. 2, 78. See also National Taxpayer Advocate Blog, *Are IRS Correspondence Audits Really Less Burdensome For Taxpayers?*, available at <http://taxpayeradvocate.irs.gov/Blog/irs-correspondence-examinations-are-they-really-as-effective-as-the-irs-thinks>.

For purposes of this discussion, we will focus on correspondence examinations, because about 70 percent of all audits are correspondence audits.<sup>4</sup> The National Taxpayer Advocate is concerned about the following problems associated with the IRS correspondence examination process:

- The correspondence examination is designed so that any available employee may assist taxpayers but no one employee is solely responsible for the outcome of the case;
- The lack of a single employee assigned to a case burdens taxpayers with repeat calls;
- The lack of an assigned employee creates downstream costs for taxpayers and the IRS;
- The lack of an assigned employee eliminates employee accountability; and
- The IRS hampers its efforts to improve customer satisfaction by not complying with the congressional directive in RRA98 § 3705(b).

The IRS's failure to provide an assigned employee, as well as the associated downstream consequences imposed on the taxpayer, violates the taxpayer's *right to quality service*, which includes "the right to receive prompt, courteous, and professional assistance."<sup>5</sup> In particular, 62 percent of calls received in the IRS correspondence examination unit are from repeat callers, which may indicate that taxpayers are not receiving the assistance they require, and their calls are being handled inadequately by employees unfamiliar with the specific issues in the audits.<sup>6</sup>

Not only does this severely impair a taxpayer's *right to quality service*, but it harms a taxpayer's *right to be informed*, as taxpayers may not be able to obtain accurate information about their cases or what they need to do to be compliant with their tax obligations. It also impacts a taxpayer's *right to challenge the IRS's position and be heard*, as having to call back over and over without an assigned employee could indicate that no one is hearing the taxpayer or understanding their issue. Last, this problem can violate a taxpayer's *right to pay no more than the correct amount of tax*, because such a system can lead to incorrect assessments.

4 IRS, 2013 Data Book, table 9a. Similar problems arise in other areas, including identify theft and Automated Collection System (ACS) cases. See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 75-83 (Most Serious Problem: *IDENTITY THEFT: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42-67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*); National Taxpayer Advocate 2011 Annual Report to Congress 48-73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*). In addition, the National Taxpayer Advocate testified at numerous hearings on the topic of identity theft. See, e.g., *Internal Revenue Service Oversight: Hearing Before the Subcomm. on Financial Services and General Government of the H. Comm. on Appropriations*, 113th Cong. 125-76 (2014) (statement of Nina E. Olson, National Taxpayer Advocate); *Examining the Skyrocketing Problem of Identity Theft Related Tax Fraud at the IRS: Hearing Before Subcomm. on Government Operations of the H. Comm. on Oversight and Government Reform*, 113th Cong. 19-41 (2013) (statement of Nina E. Olson, National Taxpayer Advocate). For information on problems related to ACS, see National Taxpayer Advocate 2012 Annual Report to Congress 381-402 (Most Serious Problem: *The Automated Collection System Must Emphasize Taxpayer Service Initiatives to Resolve Collection Workload More Effectively*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 143-48; National Taxpayer Advocate 2011 Annual Report to Congress 336-49 (Most Serious Problem: *The IRS Does Not Emphasize the Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*).

5 IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

6 See IRS, *Phone Optimization Project (POP), POP to the TOP Phone Enhancement Training Participant Guide 1* (2009) (cited by National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 at 80). See also TIGTA, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit 1* (Aug. 17, 2012). The IRS has not performed any follow up studies for this measurement. IRS response to TAS information request (Sept. 5, 2014).

## ANALYSIS OF PROBLEM

### Background

RRA 98 § 3705(b) requires that the IRS develop a procedure “to the extent practicable and if advantageous to the taxpayer” for assigning one IRS employee to handle a taxpayer’s matter until it is closed.<sup>7</sup> The Senate specified two reasons for enacting RRA 98 § 3705(b): (1) it was important that “taxpayers receive prompt answers to their questions about their tax liability”; and (2) taxpayers had expressed frustration in not being able to find the appropriate IRS employee to contact.<sup>8</sup> Senator Domenici described the situation that his constituents faced in 1998:

In New Mexico, a notice can come from the Albuquerque, Dallas, Phoenix, or Ogden IRS center. Taxpayers are often left with no option but to contact my office asking for help in simply identifying who they should talk to at the IRS to settle their tax matter. The caseworkers are experts, but it would take them two days to track down the right IRS office so that the constituent could try and solve their problem. It was so commonly befuddling to constituents that my caseworkers asked that this identification provision be included in this bill.<sup>9</sup>

In response to such concerns, Congress passed RRA 98 § 3705(b). Senator Enzi describes what Congress was trying to achieve when he said, “...the IRS reform bill will bring and demand greater accountability from the more than 100,000 employees who work for the Internal Revenue Service ... Imagine that—being able to talk to the person that knows the problem.”<sup>10</sup>

Over time, TAS has seen that some cases involve transactions that can (and should be) handled with one phone call because it is advantageous to the taxpayer.<sup>11</sup> Other cases, such as an audit—which may involve problems of substantiation, interpretations of law and other guidance, and applications of law to facts—may not be resolved with one phone call.<sup>12</sup> On multiple occasions Congress and other stakeholders, including the National Taxpayer Advocate, have reported the reasons for assigning work to one employee when a case requires it.<sup>13</sup>

7 RRA 98, Pub. L. No. 105-206 § 3705(b), 112 Stat. 685, 777 (1998).

8 S. REP. No. 105-174, at 103 (1998).

9 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici).

10 144 CONG. REC. S4147-01 (1998) (statement of Sen. Enzi).

11 Further, automation can be helpful in such cases. For detailed information on the benefits of automation, see TIGTA, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit* 16 (Aug. 17, 2012).

12 The National Taxpayer Advocate has pointed out that when taxpayers receive a notice that is hard to understand, it may be difficult for the taxpayer to reach an IRS employee for an explanation. See National Taxpayer Advocate 2008 Annual Report to Congress 163. When this happens, the IRS misses an opportunity to educate the taxpayer. *Id.*

13 See, e.g. National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 78; National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 63-90 (Research Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); National Taxpayer Advocate 2008 Annual Report to Congress 232.

In particular, the National Taxpayer Advocate has advocated for assignment of one employee in cases covering the Earned Income Tax Credit (EITC), which involves a complex statute and generally a relatively unsophisticated taxpayer.<sup>14</sup> Such an approach helps to:

- Reduce repeat taxpayer contacts;
- Reduce costs associated with reworking cases in Appeals, audit reconsideration, or through litigation; and
- Increase employee accountability.

### **The Correspondence Examination is Designed So That Any Available Employee May Assist Taxpayers But No One Employee is Solely Responsible for the Outcome of the Case.**

The IRS assigns correspondence examination cases to an employee to resolve upon receipt of correspondence or a phone call from a taxpayer.<sup>15</sup> However, the taxpayer does not necessarily have contact with this employee for the duration of the case. Instead, the IRS uses a “nationwide routing of calls,” linking multiple call centers into a “virtual” call center.<sup>16</sup> When the taxpayer subsequently calls the correspondence exam unit, the system distributes the call to the next available examiner.<sup>17</sup> For instances involving receipt of taxpayer correspondence prior to the issuance of a statutory notice of deficiency, the correspondence is assigned to an IRS employee for evaluation. If the correspondence does not resolve the issue, the case will be reintroduced to the general inventory, which means no one employee will be assigned to it.<sup>18</sup>

If the taxpayer places a phone call, the case will not be assigned if the examiner taking the call resolves the taxpayer’s concerns. For instance, if the taxpayer calls to confirm that the IRS received his or her amended return and receives an answer, then the reason for calling is resolved.<sup>19</sup> The employee who took this call is not the employee who ultimately handles the case and closes the case with an assessment, refund, or no-change letter.

When a correspondence examination employee receives a subsequent taxpayer contact, the employee who receives the contact is directed to resolve the problem himself or herself; if the taxpayer insists on reaching the specific employee, the first employee is instructed to tell the taxpayer that someone will return their call within three business days.<sup>20</sup> Unless the taxpayer requests a future date for contact, the assigned employee is expected to call the taxpayer within three business days “with the intent to resolve and close

14 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 78. Also, issues like the sales tax deduction, while very straightforward, could require numerous receipts for substantiation and could benefit from having one assigned employee. See National Taxpayer Advocate 2008 Annual Report to Congress 233.

15 This assignment can change at any time if the assigned examiner is on leave or his or her workload is too high. IRS response to TAS information request (Sept. 5, 2014). The IRS reports that assignment of case work is treated similarly regardless of how the taxpayer initially contacts the IRS. For information on the receipt of correspondence in particular, see IRM 4.19.20.1.6, *Aging*, (Jan. 1, 2009).

16 GAO, Report to the Committee on Finance, U.S. Senate, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 9 (June 2014).

17 *Id.*

18 IRM 4.19.20.1.6.1, *Taxpayer Correspondence Received PRIOR TO the Issuance of the Statutory Notice of Deficiency Non-CPS*, (April 16, 2008).

19 IRM 4.19.19.6(2), *General Taxpayer Questions*, (Jan. 1, 2014).

20 IRM 4.19.19.3.3.1(4), *CEAS Action Note*, (Jan. 2, 2013). Under this IRM provision the employee is also instructed to leave a note on the taxpayer’s account to summarize the call.

the case or move to the next status.”<sup>21</sup> IRS employees are also trained to record telephone contacts in case notes so all employees can access the information if the taxpayer writes or calls back.<sup>22</sup> The taxpayer is also informed that the acceptability of documentation received can only be made by the employee reviewing the case.<sup>23</sup>

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**The lack of accountability in these correspondence examination cases burdens taxpayers, wastes money, and impairs trust in the fairness and justness of the tax system.**

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Certainly there are business reasons for adopting these automated call-routing systems. For instance, automation can enhance speed and accuracy while promoting consistency. However, concerns raised by tax practitioners indicate that in some cases, taxpayers can benefit from working with an assigned employee. In 2012, the IRS Oversight Board held a public forum to solicit comments about the correspondence exam process.<sup>24</sup> The participants universally identified contact with IRS employees as an obstacle.<sup>25</sup>

IRS customer satisfaction results validate stakeholders’ concerns. In a 2011 study, taxpayers who contacted the IRS two times or fewer before their correspondence examination cases were resolved were among the most satisfied.<sup>26</sup> Those who contacted the IRS six or more times were among the most dissatisfied.<sup>27</sup> Additionally, as shown in Figure 1.13.1, below, customer satisfaction ratings for correspondence examination in both the Small Business and Self-Employed (SB/SE) and Wage and Investment (W&I) units are comparatively low.

- 21 IRM 4.19.19.3.2(1), *Replying to Taxpayer Inquiries*, (Nov. 7, 2013). Managers are required to monitor the cases to ensure the employees are taking timely action. IRM 4.19.19.3.2(3), *Replying to Taxpayer Inquiries*, (Nov. 7, 2013). And if a case is unassigned, the manager will ensure the notes are reviewed and worked. 4.19.19.3.2(4), *Replying to Taxpayer Inquiries*, (Nov. 7, 2013). However, this system may not always ensure contact. In a 2012 TIGTA report, TIGTA found that out of 150 calls that it sampled for its report, 20 calls involved either a taxpayer requesting a return call from the examiner or being promised one from the assistor. There was no evidence of a return call being made in 14 of those cases. See TIGTA, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make it Easier for Taxpayers to Obtain Assistance During a Correspondence Audit* 7 (Aug. 17, 2012).
- 22 IRM 4.19.13.9.2(4), *Evaluating Taxpayer Responses*, (Feb. 13, 2013). See also IRM 4.19.19.2, *Call Requirements*, (March 28, 2013).
- 23 IRM 4.19.19.2(11), *Call Requirements*, (March 28, 2013).
- 24 IRS Oversight Board, Public Forum (Feb. 28, 2012).
- 25 As an example, Lonnie Gary, chair of the Government Relations Committee of the National Association of Enrolled Agents, stated to the Board “The fact that a single person is not assigned to a correspondence audit complicates swift resolution.” Lonnie Gary, *Oral Statement of Lonnie Gary, EA, USTCP Chair, Government Relations Committee National Association of Enrolled Agents Before the Internal Revenue Service Oversight Board* 2 (Feb. 28, 2012), available at <http://www.treasury.gov/IRSOB/Documents/Panel%201-Lonnie%20Gary.pdf>. Likewise, Patricia Thompson, chair of the Tax Executive Committee of the American Institute of Certified Public Accountants (AICPA) identified four issues raised by AICPA members: (1) the excessive time it takes the IRS to resolve a taxpayer’s case; (2) the great difficulties taxpayers face when trying to contact the IRS to obtain information regarding the status of their correspondence audit case; (3) the numerous telephone inquiry calls taxpayers or their tax representative make to the IRS which go unreturned; and (4) the IRS employees routinely closing cases and issuing the statutory notice of deficiency (i.e., the “90 day letter”) without having reviewed correspondence submitted by the taxpayer. Patricia Thompson, *American Institute Of Certified Public Accountants Statement Presented To Internal Revenue Service Oversight Board Public Meeting* 3 (Feb. 28, 2012), available at <http://www.treasury.gov/IRSOB/Documents/Panel%201-Thompson-AICPA.pdf>. Last, Andre L. Re, a tax controversy consultant, testified that it was a problem to have subsequent taxpayer contacts handled by a different IRS employee each time. He recommends, “perhaps once a taxpayer response is received the case should be assigned to one employee from then on who would be responsible for further contact and case resolution.” Andre L. Re, *Presentation Of Andre L. Re* 1 (Feb. 28, 2012), available at <http://www.treasury.gov/IRSOB/Documents/Panel%201-AndreRe.pdf>.
- 26 IRS, *Internal Revenue Service Customer Satisfaction Survey, Correspondence Exam (CCE) SB/SE National Report, Covering January through March 2011, with Annual Results* 6 (July 2011).
- 27 *Id.*

**FIGURE 1.13.1, Taxpayer satisfaction outcome measures** <sup>28</sup>

Taxpayer Satisfaction	2009	2010	2011	2012	2013
SB/SE correspondence exam taxpayer satisfaction	45%	47%	47%	47%	48%
W&I correspondence exam taxpayer satisfaction	51%	50%	57%	49%	48%

### The Lack of an Assigned Employee Harms Taxpayers' Ability to Resolve Their Cases Expeditiously, Erodes Taxpayer Rights, May Cause Taxpayers and the IRS to Incur Unnecessary Expenses, and Reduces IRS Employee Accountability.

A taxpayer's *right to quality service* and *right to finality* include the ability to resolve a problem efficiently the first time around, without incurring unnecessary expenses or other burden. Taxpayers may face confusion and frustration when no single employee is assigned to their correspondence exams.<sup>29</sup> In particular, as the National Taxpayer Advocate has written in previous reports, the correspondence exam process has inherent obstacles that prevent some low income taxpayers from navigating the process successfully on their own.<sup>30</sup>

### *The Lack of an Assigned Employee Burdens Taxpayers with Repeat Calls.*

As noted above, 62 percent of those who call the correspondence exam unit are repeat callers.<sup>31</sup> A recent congressionally requested Government Accountability Office (GAO) audit sheds light on why taxpayers repeatedly call correspondence exam. The report observed that “[a]ll of the documentation sent by the taxpayer is maintained and managed in paper rather than electronic form ... IRS does not keep these data in electronic form because its information system lacks capacity, according to IRS officials.”<sup>32</sup>

This system of document retention, combined with call routing, creates problems for taxpayers with ongoing tax problems. Without access to the taxpayer's documentation, the first available examiner who answers the phone will likely not have sufficient information to answer the taxpayer's question. The examiner does have access to the electronic notes from the employee who reviewed the taxpayer's

28 IRS response to TAS information request (Sept. 5, 2014). This data is in comparison to field examination, which scored the following customer satisfaction rates: 60 percent in 2009 through 2011, 62 percent in 2012, and 63 percent in 2013. IRS, *Small Business/Self-Employed (SB/SE) Division, Field Examination Program Customer Satisfaction Survey; Final FY [sic] 2013 Annual National Report; Closed Cases April 2012–March 2013* 11 (July 13, 2013).

29 Here is one recollection from a practitioner:

Ultimately the EA [enrolled agent] constructed not one, not two, but three large mailings, each weighing a few pounds, which she sent to Ogden. During this process, she made several calls to Ogden, which were frustrated by the fact that the staff in Ogden did not have direct extensions and the EA could not leave a direct, detailed message.

Lonnie Gary, *Oral Statement of Lonnie Gary, EA, USTCP Chair, Government Relations Committee National Association of Enrolled Agents Before the Internal Revenue Service Oversight Board 2* (Feb. 28, 2012), available at <http://www.treasury.gov/IRSOB/Documents/Panel%201-Lonnie%20Gary.pdf>.

30 See National Taxpayer Advocate 2007 Annual Report to Congress 222-241 (Most Serious Problem: *EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2007 Annual Report to Congress, vol. 2 94-117 (*Research Study: IRS Earned Income Credit Audits—A Challenge to Taxpayers*); and National Taxpayer Advocate 2004 Annual Report to Congress, vol. 2 1-45 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

31 IRS, *Phone Optimization Project (POP), POP to the TOP Phone Enhancement Training Participant Guide 1* (2009) (cited by National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 80). See also TIGTA, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit 1* (Aug. 17, 2012). This problem is compounded by the fact that in FY 2014, only 64.4 percent of taxpayers calling to speak to an IRS customer service representative could get through and the average time on hold was 19.55 minutes. IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (week ending Sept. 30, 2014).

32 GAO, Report to the Committee on Finance, U.S. Senate, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 19 (June 2014).

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**The Senate specified two reasons for enacting § 3705(b) of the IRS Restructuring and Reform Act of 1998: (1) it was important that “taxpayers receive prompt answers to their questions about their tax liability”; and (2) taxpayers had expressed frustration in not being able to find the appropriate IRS employee to contact.**

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information (if the review has taken place).<sup>33</sup> However, the case notes left by one employee may not make sense to the next, preventing that person from answering the taxpayer’s question correctly.<sup>34</sup> Lastly, taxpayers may be calling repeatedly because they do not get consistent information from one tax examiner to the next.<sup>35</sup> With no concrete way of knowing when and by whom the review of their records will occur, or if they have sufficiently complied with IRS requests for information, it is understandable that taxpayers repeatedly call for updates.

In 2012, TAS reviewed a sample of cases where taxpayers petitioned the Tax Court for review of IRS disallowance of the Earned Income Tax Credit (EITC) and where the IRS conceded the EITC issue in full without trial (hereafter the 2012 EITC study). The study found that of the cases reviewed, 63 percent of the taxpayers tried to resolve their issues by calling the IRS before filing their petitions, calling five times on average.<sup>36</sup> Even with multiple contacts, the taxpayers still had to go to Tax Court to get the right answer. The lack of accountability in these correspondence examination cases burdens taxpayers, wastes money, and impairs trust in the fairness and justness of the tax system.

The high volume of repeat calls erodes the taxpayer’s *right to be informed* because taxpayers cannot obtain answers about what they need to do to comply with tax laws. Likewise, the taxpayer’s *right to quality service* is harmed because taxpayers are denied prompt service. If one employee is assigned to a taxpayer’s case, that employee can give a definitive answer as to when the taxpayer should expect an update and answer questions specific to that case. The taxpayer may wait longer to speak to the assigned employee but the overall process would improve because the taxpayer would have contact with the correct employee who would also be accountable. Moreover, the taxpayer would not have to repeatedly explain his or her situation because the assigned employee would be familiar with the taxpayer’s case and the preceding discussions. This approach supports the taxpayer’s *right to challenge the IRS’s position and be heard*.

#### *The Lack of an Assigned Employee Creates Downstream Costs for Taxpayers and the IRS.*

Both the taxpayer and the IRS incur expenses that may be related directly to not having an employee assigned earlier in the case. When a taxpayer cannot reach an employee during an examination to get an answer or to follow up with documentation, mistakes may happen and the taxpayer may appeal a proposed assessment.<sup>37</sup> Taxpayers must either hire representatives or work with the IRS on their own, while the IRS must provide trained Appeals staff to rework the cases.

If the taxpayer does not exercise his or her appeal rights, Examination may issue a statutory notice of deficiency (SNOD).<sup>38</sup> The SNOD provides the taxpayer with the only opportunity to have judicial review of the case without prepaying the assessment. To exercise this right, the taxpayer must file a petition in

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33 GAO, Report to the Committee on Finance, U.S. Senate, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 19 (June 2014).

34 See National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 79.

35 GAO, Report to the Committee on Finance, U.S. Senate, *IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 18 (June 2014). The GAO obtained this information as a result of a tax examiner focus group interview.

36 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 77.

37 Treas. Reg. § 601.105(b)(4). This is a statement of procedural rule, which provides guidance but is not codified.

38 See IRC § 6212.

the United States Tax Court—so again, taxpayers must either retain representatives during litigation or develop cases on their own; while the IRS incurs the expense of providing Counsel for its representation. The additional costs incurred through Appeals and litigation undermine the *right to a fair and just tax system*.

Taxpayers who do not agree with the audit outcome may also pursue an audit reconsideration, which allows taxpayers to submit information not previously considered in the examination.<sup>39</sup> In FY 2013, Correspondence Exam conducted 1,060,779 exams.<sup>40</sup> In FY 2013, the IRS also conducted 69,037 audit reconsiderations stemming from correspondence exams.<sup>41</sup> Audit reconsiderations are important to measure because these are cases where the IRS is reworking the same issue a second time.

In FY 2014, the IRS performed 857,410 correspondence examinations on individual taxpayers,<sup>42</sup> and TAS worked 17,373 correspondence examination cases involving individuals.<sup>43</sup> Each TAS case that involves a correspondence examination issue represents an instance where two IRS employees are needed to resolve the taxpayer's problem. Many of the TAS correspondence exam cases may result from the IRS's failure to assign one employee who is responsible for and knowledgeable about the facts and issues in the case.

### *The Lack of an Assigned Employee Reduces Employee Accountability.*

The lack of an assigned employee eliminates or reduces IRS employee accountability, which contributes to the problems previously identified. As the National Taxpayer Advocate has pointed out, under current procedures “[n]o one employee must follow up on his or her actions or decisions with respect to a case or speak with the taxpayer about those decisions.”<sup>44</sup> The absence of accountability impairs the taxpayer's *right to a fair and just tax system*, which provides that the IRS employee will consider the taxpayer's specific facts and circumstances.

The lack of accountability has real costs for both the taxpayer and the IRS. As discussed above, the 2012 EITC study shows that a majority of taxpayers in the study population attempted to work with the IRS earlier in the process. These cases were resolved once a Tax Court petition was filed and IRS Counsel conceded the case without going to trial. Some taxpayers must wait until this lengthy process ends to obtain their refunds. In fact, the 2012 EITC study showed that almost 39 percent of the taxpayers had to wait an average of almost one and a half years for the refund to which they were entitled.<sup>45</sup> The IRS could avoid this long wait by providing more accountability earlier in the process.

Lack of accountability also contributes to increased costs for the IRS, as higher-paid employees must rework the same cases. In particular, the 2012 EITC study highlighted the fact that the IRS incurs cost in employing higher-grade employees when the correct answer is missed earlier in the process.<sup>46</sup> In 20 percent of the cases reviewed, a higher-graded employee in Appeals or Chief Counsel accepted

39 For information on audit reconsiderations generally, see IRM 4.13.1.1, *Overview*, (Oct. 1, 2006).

40 IRS, FY 2013 Data Book, Table 9a. This represents 75.5 percent of all examinations on individual tax returns. IRS, FY 2013 Data Book Table 9a.

41 IRS, Individual Master File and the Audit Information Management System, closed case database.

42 Audit Information Management System Closed Case Data on the IRS Compliance Data Warehouse.

43 There were an additional 953 taxpayers who had both a correspondence examination and a non-correspondence examination. This number does not include correspondence examinations of businesses. TAMIS data (Nov. 3, 2014).

44 See National Taxpayer Advocate Blog, *Are IRS Correspondence Audits Really Less Burdensome For Taxpayers?*, available at <http://taxpayeradvocate.irs.gov/Blog/irs-correspondence-examinations-are-they-really-as-effective-as-the-irs-thinks>.

45 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 77.

46 *Id.*, vol 2 75.

documentation from a taxpayer that the examiner rejected.<sup>47</sup> In addition, in over one third of the cases, the IRS paid interest on the delayed refunds, averaging approximately \$200 per return.<sup>48</sup>

### The IRS Has Misplaced Its Efforts to Improve Customer Satisfaction by Overlooking Congressional Intent Behind RRA 98 §3705(b).

The IRS explains that its decision to not adopt an “exclusive assignment of cases” is the result of research showing that universal access to work papers and case histories allows any tax examiner to assist a taxpayer.<sup>49</sup> However, as practitioner feedback, the GAO study, and customer satisfaction ratings demonstrate, taxpayers do not always receive appropriate service from the first available examiner. While the IRS has studied how to improve the correspondence exam process, its studies do not consider the benefits of assigning one employee to cases once the taxpayer has engaged with the IRS or the amount of rework created by not assigning one employee.<sup>50</sup>

In 2008, the IRS initiated the Phone Optimization Project (POP) team to improve taxpayer satisfaction in correspondence examination. The team focused on:

- Ease of getting through to the right person;
- Length of correspondence exam process;
- Providing consistent information about the case;
- Length of time to get through by phone; and
- Explanation of adjustments.<sup>51</sup>

Most of these issues can be addressed (or even eliminated) by assigning an employee to certain cases. Perhaps the length of time to get through by phone would not be improved with an assigned employee because taxpayers may need to leave a message and wait for a call-back. However, because the taxpayer would not need to call multiple times or repeat the same information over and over to different employees, and because the assigned employee would be familiar with the facts of the case and knowledgeable what is *specifically* needed to resolve the case, overall cycle times could be reduced, and the overall experience might improve.

The POP team did not include single employee assignment once the taxpayer engages the IRS (whether through phone, mail, or fax) as a solution. Instead, the team focused on improving phone access and revising correspondence receipt and triage.<sup>52</sup> This decision may come from an underlying policy determination that any exam employee is the “right” employee for the taxpayer to call, a view that fails to consider the downstream work when taxpayers need one employee assigned to their case.<sup>53</sup>

The National Taxpayer Advocate finds this policy misguided. While universal call routing may be appropriate for industries such as airlines, the transactions one generally undertakes in those industries are

47 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 89.

48 See *id.*, vol. 2 77.

49 IRS response to TAS information request (Sept. 5, 2014).

50 See IRS, *Correspondence Examination Assessment Project (CEAP)* (Sept. 30, 2013); POP Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination, Briefing Document* (June 21, 2010).

51 POP Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination, Briefing Document 6* (June 21, 2010).

52 POP Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination, Briefing Document 9* (June 21, 2010).

53 IRS, *Phone Optimization Project (POP), POP to the TOP Phone Enhancement Training Participant Guide 5* (2009).

narrow, discrete tasks that usually can be completed in one call, like purchasing an airline ticket. IRS audits, on the other hand, are categorically different from purchasing an airline ticket. Audits involve issues of proof, interpretation of law and guidance, and usually result in a tax assessment that will be collected by the IRS—*i.e.*, multiple enforcement actions. Adopting an approach that works for the airline industry is inappropriate where the assessing and taking of taxpayer property is concerned.

The IRS also implemented the Correspondence Examination Assessment Project with the intent of reviewing and improving the correspondence exam process.<sup>54</sup> Initially, this review included “single point of contact” as a way to improve the correspondence exam process.<sup>55</sup> Ultimately, CEAP promoted self-assignment of cases by employees to encourage case resolution during the first interaction with a taxpayer.<sup>56</sup> This means that employees answering phone lines can assign cases to their own inventory from another campus.<sup>57</sup>

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**While universal call routing may be appropriate for industries such as airlines, the transactions one generally undertakes in those industries are narrow, discrete tasks that usually can be completed in one call, like purchasing an airline ticket. IRS audits, on the other hand, are categorically different from purchasing an airline ticket.**

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Without addressing the assignment of cases to a single employee, the IRS overlooks solutions that could improve the taxpayer experience and be “advantageous to the taxpayer.” For instance, the IRS uses Automated Correspondence Examination, a system that processes cases until a response is received from the taxpayer.<sup>58</sup> Under this system, mail is initially sorted and certain types of correspondence are removed, such as misrouted, undeliverable, or unclaimed mail.<sup>59</sup> For any mail still remaining after this sort, the IRS will research to determine if the case is assigned to an employee. If the case is unassigned, the mail is routed within five days based on local management procedure.<sup>60</sup>

The IRS could continue to automatically process cases up to the point that the taxpayer engages with the IRS—either via correspondence or via a phone call, when a case would be assigned to a specific employee. Under this recommendation, the IRS would continue to batch and assign cases to general groups of employees. However, once a taxpayer contacts the IRS on an unassigned case, either by correspondence or by calling, local management procedure could dictate that the employee who receives the contact would thereafter “own” the case. That employee would familiarize himself or herself with the case, be accountable for the case outcome, and serve as the contact for any future interactions with the taxpayer. If the initial taxpayer contact completely resolves the issue, the employee would close the case.

54 IRS, *Correspondence Examination Assessment Project (CEAP)* 4 (Sept. 30, 2013). This initiative developed in response to critical feedback about the correspondence exam program from stakeholders including the National Taxpayer Advocate. GAO, *Report to the Committee on Finance, U.S. Senate, IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 11 (June 2014).

55 IRS, *Correspondence Examination Assessment Project (CEAP)* 16 (Sept. 30, 2013).

56 IRS, *Correspondence Examination Assessment Project (CEAP) Executive Briefing* 7-8 (April 1, 2014). The GAO pointed out that the CEAP effort to promote self-assignment of cases was not clearly defined or tracked. As a result, the benefits of this effort may not be realized. GAO, *Report to the Committee on Finance, U.S. Senate, IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden* 35 (June 2014). The IRS claims that assignment of one employee was not eliminated, but was “clarified to be more about resolution than providing a specific name.” IRS response to TAS information request (Oct. 23, 2014).

57 For information on self-assignment of cases, see IRM 4.19.19.3.5(1), *Self-Assign General*, (Jan. 1, 2014).

58 See IRM 4.19.20.1, *Automated Correspondence Exam Overview*, (May 21, 2013).

59 See IRM 4.19.21.2(9), *Processing Incoming Correspondence*, (July 30, 2013).

60 See *id.*

Additionally, the IRS could expand use of virtual service delivery (VSD), which includes videoconferencing technology, to mitigate the delays caused by repeat calls.<sup>61</sup> The taxpayer could make an appointment, similar to an office audit, and even if the VSD appointment did not resolve all issues, the taxpayer would walk away knowing what else he or she needs to do. If a taxpayer is offered a virtual office audit, the employee handling the videoconference would then “own” the case until resolution.

## CONCLUSION

Automation can assist both the IRS and taxpayers. However, the IRS must use automation in a way that benefits taxpayers and respects taxpayer rights. Systems such as universal call routing may allow a taxpayer to reach an IRS employee relatively quickly, but as described above, the system may not provide the appropriate assistance taxpayers need in audits or collection matters. Taxpayers often require ongoing assistance to resolve their correspondence examinations, particularly because the tax code is so complex. These are the cases Congress had in mind when it passed RRA 98 § 3705(b)—cases where it would be “advantageous to the taxpayer” to assign one employee.

However, the IRS currently treats all correspondence exam cases as if they can be resolved with one contact or by the next available employee. The IRS has chosen to stick with systems that do not meet the needs of taxpayers instead of developing procedures to identify when a taxpayer would benefit from having a single assigned employee. This business practice fails to adhere to the congressional intent of § 3705(b), creates downstream costs for both the IRS and the taxpayer, and undermines *the right to quality service, the right to be informed, the right to challenge the IRS’s position and be heard, and the right to a fair and just tax system*. The IRS can follow the intent expressed in § 3705(b) by reviewing its current practices in light of downstream consequences and using technological advances that have occurred since the passage of the law.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Analyze the additional work caused by the current approach taken in correspondence exam. Based on that review, develop procedures and staffing models that enable cases to be assigned to one employee once the taxpayer has contacted the IRS.
2. Allow the taxpayer to individually choose service options to his or her advantage, such as leaving a voicemail for the employee owning the case or speaking with the next available employee.
3. Design extension routing capabilities to enable taxpayers to reach the employee assigned to their cases.
4. Include an option for single employee assignment in all technology developments, including VSD.

61 In RRA 98, Congress intended the IRS to utilize technology to enhance taxpayer services. For more information, see Most Serious Problem: *VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services, infra.*

**MSP  
#14****AUDIT NOTICES: The IRS's Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division

Karen Schiller, Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM<sup>1</sup>**

Concerned about taxpayers being unable to reach IRS employees both knowledgeable about and accountable for the taxpayers' cases, in § 3705(a) of the IRS Restructuring and Reform Act of 1998 (RRA 98) Congress required the IRS to include the name, telephone number, and unique employee identification number in any "manually generated correspondence."<sup>2</sup> The IRS has failed to meaningfully implement the requirements of § 3705(a).<sup>3</sup> The IRS does not include appropriate employee contact information on most computer-generated notices, even when a particular employee has worked on the case.<sup>4</sup>

The National Taxpayer Advocate has identified the following concerns about IRS audit notices:

- The IRS failed to include contact information for a specific employee on any letter in the sample, even in the five percent of letters where an IRS employee had obviously customized the letter for the specific taxpayer, based on a review of a sample of 100 Letter 105-Cs, *Notice of Claim Disallowance*.<sup>5</sup>
- Where the IRS includes a "name" on most correspondence, it is either so generic as to be meaningless, such as "Tax Examiner," or is a person so high in the chain of management that a taxpayer cannot reach an individual employee who is personally knowledgeable about the case even after the IRS proposes changes to the account;<sup>6</sup> and

1 This Most Serious Problem acts in concert with the Most Serious Problem: CORRESPONDENCE EXAMINATION: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*, *supra*. The two pieces must be read together and for true accountability the recommendations from both should be implemented in tandem. The companion Most Serious Problem focuses on Pub. L. No. 105-206, § 3705(b) (1998) and discusses the burden imposed on both the IRS and taxpayers as a result of the IRS's failure to assign a single employee to correspondence exams where the taxpayer has contacted the IRS.

2 Pub. L. No. 105-206, § 3705(a) (1998).

3 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998* (May 28, 2014). The report shows that the IRS took 57 actions to comply with § 3705 of RRA 98. Of those 57 actions, only seven can be reasonably construed as addressing contact information on correspondence or attempting to assist a taxpayer in reaching a specific IRS employee. Many of the actions taken to implement § 3705 involve creating unique employee identification numbers or determining how to provide assistance in Spanish.

4 Internal Revenue Manual (IRM) 21.3.3.4.16.1, *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

5 Sample set of Letter 105-Cs on file with TAS Attorney Advisor Group.

6 IRM 4.19.10.1.6(6), *Correspondence Examination Letters* (Jan. 1, 2013). See, e.g., Letter 105-C, *Claim Disallowed*, and Letter 106-C, *Claim Partially Disallowed* (containing contact information for a high level IRS official and Letter 525, *General 30 Day Letter*, containing general contact information for the generic "Tax Examiner").

- Employees can generate notices anonymously, particularly in correspondence audits, which can erode accountability for actions taken or not taken in a case.<sup>7</sup>

While it may be unnecessary or impractical to include contact information for a specific employee on all notices, particularly before a case is assigned, failing to do so after a taxpayer has communicated with the IRS may violate the law and contradict the IRS's own Internal Revenue Manual. At a minimum, campus correspondence procedures fail to address Congress' concerns regarding the inability of taxpayers to contact an IRS employee who is knowledgeable about and accountable for the case. This situation also erodes several essential taxpayer rights—*the right to quality service, the right to be informed, and the right to a fair and just tax system*—articulated in the Taxpayer Bill of Rights.<sup>8</sup>

## ANALYSIS OF PROBLEM

### Background

As a starting point for restructuring the IRS, the National Commission on Restructuring the Internal Revenue Service produced a report, *A Vision of a New IRS*, wherein it set forth a fundamental starting point for reform:

As a guiding principle, the Commission believes that taxpayer satisfaction must become paramount at the new IRS and that the IRS should only initiate contact with a taxpayer if the agency is prepared to devote the resources necessary for a proper and timely resolution of the matter.<sup>9</sup>

The text of RRA 98 demonstrates that this guiding principle was at the forefront of § 3705(a), where Congress attempted to remedy the inability of taxpayers to reach an IRS employee familiar with their case.<sup>10</sup> The Joint Committee on Taxation reported the reason for this change to the law was so taxpayers could receive prompt answers to questions about their tax liabilities, as many expressed frustration at not knowing which employee to contact.<sup>11</sup>

### *Members of Congress Were Concerned About Taxpayers' Access to IRS Employees with Knowledge of Their Cases.*

Before RRA 98 was enacted, taxpayers who received notices without specific contact information for the employees handling their cases were sometimes left with no alternative but to seek help from members

7 IRM 4.19.20.1(1), *Automated Correspondence Examination Overview (ACE)* (May 21, 2013) (“Using the ACE [Automated Correspondence Examination], Correspondence Examination can process specified cases with minimal to no tax examiner involvement until a taxpayer reply is received. Because the ACE system will automatically process the case through creation, statutory notice and closing, tax examiner involvement is eliminated entirely on no-reply cases. Once a taxpayer reply has been considered, the case can be reintroduced into ACE for automated Aging and Closing in most instances.”) For a detailed discussion of the National Taxpayer Advocate’s concerns regarding assigning one IRS employee to handle a taxpayer’s matter until it is closed, see Most Serious Problem: CORRESPONDENCE EXAMINATION: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*, *supra*.

8 The IRS adopted the Taxpayer Bill of Rights on June 10, 2014. See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also IRS, Publication 1, *Your Rights as a Taxpayer* (2014).

9 National Commission on Restructuring the Internal Revenue Service, *A Vision for a New IRS*, 5 (1997).

10 Pub. L. No. 105-206, § 3705(a) (1998) (“Any manually generated correspondence received by a taxpayer from the Internal Revenue Service shall include in a prominent manner the name, telephone number, and unique identifying number of an Internal Revenue Service employee the taxpayer may contact with respect to the correspondence...”).

11 J. Comm. on Tax’n, *General Explanation of Tax Legislation Enacted in 1998*, 128 (1998).

of Congress in finding them. Senator Domenici of New Mexico spoke to this point during the debate leading up to RRA 98:

In New Mexico, a notice can come from the Albuquerque, Dallas, Phoenix, or Ogden IRS center. Taxpayers are often left with no option but to contact my office asking for help in simply identifying who they should talk to at the IRS to settle their tax matter. The caseworkers are experts, but it would take them 2 days to track down the right IRS office so that the constituent could try and solve their problem. It was so commonly befuddling to constituents that my caseworkers asked that this identification provision be included in this bill.<sup>12</sup>

Senator Domenici further stated: “I can’t believe we have to pass a Federal statute to accomplish this next task but apparently we do. The bill requires all IRS notices and correspondence to include the name, phone number, and address of an IRS employee the taxpayer should contact regarding the notice.”<sup>13</sup>

IRS stakeholders, including the American Institute of Certified Public Accountants (AICPA), proposed similar requirements for IRS notices as early as 1988.<sup>14</sup> Twenty-six years later, stakeholders are still expressing similar, and valid, sentiments. For example, during a 2012 IRS Oversight Board Public Forum panel discussion, the National Association of Tax Professionals voiced concerns about IRS employee accountability where no single employee is assigned to a correspondence exam and the extra burden this causes taxpayers when they need to explain their case to a new employee on each subsequent IRS contact.<sup>15</sup>

### *Members of Congress Were Also Concerned About IRS Employee Accountability for Actions on Taxpayer Cases.*

Hearings leading up to RRA 98 focused on taxpayer experiences with IRS employees.<sup>16</sup> During a panel hearing, the Senate heard the testimony of four taxpayers<sup>17</sup> who spoke of intimidation, threats, not knowing who they were talking to since employees did not sign their names to notices, paying taxes they knew they did not owe, the inability to get the same answer twice from employees, and not being able to talk to the same employee.<sup>18</sup> During the same set of hearings, Senators Moynihan and Grassley referred to accountability for IRS employees with Senator Grassley stating, in regards to the behavior described by the taxpayer panel, that “when heads roll, then it sends a clear signal to other people that this sort of action will not be tolerated.”<sup>19</sup>

12 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici).

13 *Id.*

14 *Serious Problems Exist in the Quality of IRS Correspondence with Taxpayers: Hearing Before a H. Subcomm. of the Comm. on Government Operations, 100th Cong. 108 (1988)* (statement of Ida Bergman, Chairman of the Tax Administration Subcommittee of the AICPA). Mr. Bergman stated: “One example [of lack of sufficient information on correspondence] is the necessity to have on the notice the name of the person at the Internal Revenue Service with whom to correspond after the first response by the taxpayer. Getting effective communication with the Service, without knowing the person to speak to, is most frustrating.”

15 See also National Association of Tax Professionals (NATP), *IRS Oversight Board Public Forum: Panel 1: How Can Correspondence Audits Be More Effective for the IRS and Less Burdensome for Taxpayers?* (Feb. 28, 2012). The NATP noted concerns about IRS employee accountability when no single employee is assigned to a correspondence exam and the burden on taxpayers when they need to explain their case to a new employee on each IRS contact.

16 *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance, 105th Cong. 105-190 (1997)*.

17 *Id.*

18 *Id.*

19 *Id.* at 97 (1997) (statement of Sen. Grassley).

After the taxpayers concluded testifying, the Senate Finance Committee called then-Acting Commissioner Dolan to testify. Senator Roth, Chairman of the Senate Finance Committee, questioned Acting Commissioner Dolan about employee accountability.<sup>20</sup> The Chairman asked Acting Commissioner Dolan if indeed the IRS intended to hold employees accountable going forward, then wouldn't their names need to be included on future notices?<sup>21</sup> The Acting Commissioner acknowledged that notices needed work, that a series of notices were not signed, and some contained only a phone number.<sup>22</sup> These hearings emphasize the importance Congress placed on employee accountability in the debate leading to RRA 98.

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**The IRS reports it took 57 actions related to § 3705 of the IRS Restructuring and Reform Act of 1998, but none involved a comprehensive review of correspondence to determine which notices should be considered manually generated and contain employee contact information.**

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### *Congress Did Not Define the Phrase “Manually Generated.”*

The final text of RRA 98 contains the words “manually generated” in § 3705(a).<sup>23</sup> However, the act does not define the phrase “manually generated,” nor do the words appear in any discussion involving § 3705(a). The original Senate discussion framing the section addressed a bill that would have required all IRS notices and correspondence to contain employee contact information.<sup>24</sup>

While the available record is silent on how the term “manually generated” arose, Senate Finance Committee hearing testimony shows that Acting Commissioner Dolan stated that he would like to come back to Chairman Roth and talk about the entire universe of notices and draw distinctions between types of notices.<sup>25</sup> This suggests a conversation about types of notices may have occurred off the record or in correspondence that remains sealed.<sup>26</sup> It is possible that if this discussion occurred or letters were written about the IRS notice process, the IRS may have clarified to the Senate its procedures for sending automatic notices before an employee would have looked at a case, resulting in the reference to “manually generated.”

### **The IRS Has Not Adequately Implemented Section 3705(a) or Addressed Congress’s and Stakeholder Concerns About Access to the IRS and Employee Accountability.**

Following the enactment of RRA 98, the IRS Office of Legislative Affairs tracked all actions the IRS took to comply with the implementation of the law.<sup>27</sup> The IRS reports it took 57 actions related to § 3705 of RRA 98,<sup>28</sup> but none involved a comprehensive review of correspondence to determine which notices

20 *Practices and Procedures of the Internal Revenue Service: Hearings Before the S. Comm. on Finance*, 105th Cong. 105-190 (1997).

21 *Id.* at 214 (1997) (testimony of Michael Dolan, Acting Commissioner of the Internal Revenue Service).

22 *Id.*

23 Pub. L. No. 105-206, § 3705(a) (1998). The words “manually generated” did not appear until the Conference version of the bill in June 1998. 144 CONG. REC. H5100-01 (1998).

24 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici). See also S. REP. No. 105-174, 103 (1998) (“The provision requires that all IRS notices and correspondence contain a name and telephone number of an IRS employee whom the taxpayer may call.”).

25 *Practices and Procedures of the Internal Revenue Service: Hearing Before the S. Comm. on Finance*, 105th Cong. 105-190, at 214 (1997) (testimony of Michael Dolan, Acting Commissioner of the Internal Revenue Service).

26 S. Res. 474, 96th Cong. (1980) (enacted) “Sec. 2. (a) Subject to such rules and regulations as the Secretary of the Senate may prescribe, any other records of the Senate or any committee of the Senate which are so transferred may be made available for public use—(2) in the case of all other such records, when such records have been in existence for twenty years.”

27 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998*, (May 28, 2014).

28 *Id.*

should be considered manually generated and contain employee contact information.<sup>29</sup> Nor did the IRS seek an official legal opinion from the Office of Chief Counsel regarding the requirement to include contact information on manually generated notices. Of the actions, only seven could be reasonably interpreted as providing employee contact information on correspondence or assisting a taxpayer in finding a specific employee on a subsequent contact.<sup>30</sup> Four actions included awareness memos to employees about the requirement to include employee contact information on notices, two involved procedures on locating employees by badge or name on subsequent employee contacts, and one involved including tax examiner information on a specific class of real property tax notices.<sup>31</sup>

The IRS's implementation of § 3705(a) highlights concerns about the IRS audit process as it stands today. Notices in the audit process often request a time-sensitive response from the taxpayer or trigger a taxpayer's legal rights, including the right to an appeal and the right to petition the Tax Court.<sup>32</sup> Particularly where notices are legally significant, such as with Statutory Notices of Deficiency, the taxpayer should be provided with a specific employee to contact.<sup>33</sup>

The IRM on correspondence exam notices provides that 69 letters mailed on cases from the Campus Correspondence Examination inventory (the part of the IRS that audits a taxpayer's return solely via letter) "will include the appropriate BOD (business operating division) corporate toll free number, 'Tax Examiner' as the person to contact and the site specific identification number."<sup>34</sup> This instruction covers both cases where the taxpayer has not responded and others where the taxpayer either wrote to the IRS or spoke with an employee, yet subsequent correspondence to that taxpayer still does not contain contact information for the employee who read the first letter or spoke with the taxpayer by phone.<sup>35</sup>

The IRS automatically issues millions of notices every year.<sup>36</sup> Assigning an individual employee to each of these cases is not necessarily practical. At the least, however, once a taxpayer has written to or called the IRS, the contact information of the employee who reviews that correspondence or answers the call should appear on all future correspondence regarding that issue.<sup>37</sup>

Instead, the current IRS practice is to put taxpayers back into the IRS Automated Correspondence Exam (ACE) program for automatic case aging and processing even if the taxpayer has contacted the IRS.<sup>38</sup>

29 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998*, (May 28, 2014).

30 *Id.* Actions AT-2009-13272, AT-2009-13276, AT-2009-13284, AT-2009-13300, AT-2009-13301, AT-2009-13307, and AT-2009-13327 address including contact information on notices or assisting taxpayers in finding a specific IRS employee.

31 IRS, Office of Legislative Affairs, *Enacted Law Report for the Restructuring and Reform Act of 1998* (May 28, 2014). Actions AT-2009-13272, AT-2009-13276, AT-2009-13284, AT-2009-13300, AT-2009-13301, AT-2009-13307, and AT-2009-13327.

32 See, e.g., Letter 531, *General Statutory Notice of Deficiency*.

33 See *id.*

34 IRM 4.19.10.1.6, *Correspondence Examination Letters* (Jan. 1, 2013). Sixty-nine letters are included in IRM 4.19.10.1.6(2) which are generated from the Campus Correspondence Examination inventory and will only contain a generic contact.

35 IRM 4.19.20.1(1), *Automated Correspondence Examination Overview (ACE)* (May 21, 2013). "Once a taxpayer reply has been considered, the case can be reintroduced into ACE for automated Aging and Closing in most instances."

36 IRS Compliance Data Warehouse (CDW), Notice Delivery System, fiscal year (FY) 2014 (Nov. 2014).

37 We discuss the assignment of a single employee to correspondence exam cases in the companion Most Serious Problem. Most Serious Problem: CORRESPONDENCE EXAMINATION: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*, *supra*. The recommendations in both pieces should be implemented in tandem for full accountability. As with the recommendation to assign an employee to a case once the taxpayer has contacted the IRS, similarly, not all correspondence exams require an employee assignment. However, once a taxpayer has engaged with the IRS, the employee who answered the phone call or correspondence should be assigned to the case until the issue is resolved, improving employee accountability and providing a taxpayer with an employee knowledgeable about the case.

38 IRM 4.19.20.1(1), *Automated Correspondence Examination Overview (ACE)* (May 21, 2013).

This practice does not facilitate taxpayer access to the employee knowledgeable about his or her case. Nor does it foster accountability of IRS employees who close those cases without communicating with the taxpayer or addressing concerns.

### The IRS's Systems Seem to Be Set to Ignore the IRM Definition of "Manually Generated Correspondence" and as a Result Most Audit Correspondence Does Not Contain Specific Employee Contact Information.

The IRS definition of manually generated correspondence, where the contact information of the IRS employee working the case should be included, includes correspondence where the employee has exercised judgment in working or resolving the case.<sup>39</sup> However, even where correspondence is generated only because of an IRS employee working and making decisions on a taxpayer's case, the correspondence still does not contain the name and contact information for the employee.<sup>40</sup>

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Twenty-six years after the enactment of the IRS Restructuring and Reform Act of 1998, tax professionals continue to voice concerns about IRS employee accountability where no single employee is assigned to a correspondence exam and the burden on taxpayers when they need to explain their case to a new employee on each IRS contact.

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The IRS ACE program exists solely to conduct examinations with little or no human involvement.<sup>41</sup> Notices and letters are sent automatically via a computer program without specific contact information, even if an employee exercised judgment in the case or is requesting information, in seeming violation of the IRM. These letters notify taxpayers that their refunds have been frozen, deductions have been disallowed, further information is required to verify the return, and more.<sup>42</sup>

TAS pulled a sample of Letter 105-C, *Claim Disallowance*, which notifies taxpayers that their claim for a refund or tax credit has been disallowed.<sup>43</sup> Of the sample of 100 letters, none were signed by an individual employee who would have worked on the case; instead, all were stamped with the signature of a high-level manager or even program director.<sup>44</sup> While most of the letters contain standard paragraphs, that either an employee or the computer can select as a letter is generated, five of the letters contained specific, non-standardized information about the taxpayers' particular situations.<sup>45</sup>

One letter even referred to correspondence that a taxpayer submitted to substantiate the credit claimed, which would have required an employee to review the correspondence and decide if it was valid to support the claim.<sup>46</sup> In these cases, it is clear that an employee worked the case and exercised discretion to determine

39 IRM 21.3.3.4.16.1, *Preparation of Outgoing Correspondence* (Oct. 25, 2007). The IRS defines "manually generated correspondence" in the IRM as "correspondence issued as a result of an IRS employee exercising his/her judgment in working/resolving a specific taxpayer case or correspondence, or where the employee (Tax Examiner, Revenue Agent, Revenue Officer, etc.) is asking the taxpayer to provide additional case-related information." The IRS defines "non-manually generated correspondence" in the same IRM: "Non-manually generated correspondence may be issued as a result of the taxpayer filing a return, using an automated system, or requesting information about an account or tax law matter either by telephone or in writing. This correspondence does not require the name of a specific employee to whom the taxpayer needs to talk in connection with the letter received."

40 See IRM 4.19.10.1.6(6), *Correspondence Examination Letters* (Jan. 1, 2013). Sixty-nine letters are listed which will only contain generic contact information when issued on campus exam inventory.

41 IRM 4.19.20.1, *Automated Correspondence Examination Overview* (May 21, 2013).

42 See, e.g., Letter 565, *Acknowledgement and Request for Additional Information*.

43 IRS, Letter 105-C, *Claim Disallowance*.

44 Sample set on file with TAS Attorney Advisor Group.

45 IRS, Letter 105-C, *Claim Disallowance*.

46 Sample set on file with TAS Attorney Advisor Group.

the validity of the taxpayers' claims, yet the letters still only contain the signature of a high level manager, not the contact information for the employee who made the decision and is familiar with the case.<sup>47</sup>

Although the IRS has issued over 560,000 105C letters in FY 2014 and many are standardized due to a mismatch of information between what a taxpayer has reported on a tax return and what the IRS has on file from third party reporters, it is clear that not all 105C letters are automatically generated.<sup>48</sup> In cases where these notices are issued by an employee who reviewed a taxpayer's account and made a decision, according to its own IRM, the IRS should provide that specific employee's name and contact information.<sup>49</sup> Failure to do so leaves the taxpayer with no way to contact an employee accountable for the decision. It also fails to address Congress' concerns that taxpayers be able to reach an IRS employee both knowledgeable and accountable for the taxpayer's case.

### **The IRS's Failure to Include Employee Contact Information on Campus Correspondence Burdens Taxpayers, Erodes Employee Accountability, and May Delay Case Resolution.**

Lacking an initial specific employee to contact, a taxpayer may call the generic IRS number printed in the notice. As the IRM states, "Any employee answering the Toll-Free number should be able to respond appropriately."<sup>50</sup> Each time taxpayers call the IRS, they must explain their situation again to the new employee who answers the general toll-free line.<sup>51</sup>

While taxpayers have indicated in focus groups that their desire to speak to an employee is greater than their desire to speak to the specific employee who made the decision on their case, this only holds true so long as the employees are "on the same page" and "know what they are doing."<sup>52</sup> However, employees are not always on the same page. A taxpayer who needs to contact the IRS more than once usually never speaks to the same person twice and the employee who answers the phone on a subsequent call will have to interpret notes, if any, that the previous employee has recorded.<sup>53</sup> Employees are expected to take notes while on a call with the taxpayer.<sup>54</sup> Taxpayers complain that they are frustrated with talking to tax examiners who do not have their files, having to resubmit paperwork, not having documentation acknowledged, having to repeat conversations, not receiving return calls, and not being able to get their cases resolved while on the phone.<sup>55</sup> Notably, 62 percent of calls received in the IRS correspondence examination unit are from repeat callers, which may indicate that taxpayers are not receiving the assistance they require, and their calls are being handled inadequately by employees unfamiliar with the

47 Sample set on file with TAS Attorney Advisor Group.

48 IRS, CDW, Notice Delivery System FY 2014 (Nov. 2014). For FY 2014, the IRS has issued 564,008 105-C letters.

49 IRM 21.3.3.4.16.1, *Preparation of Outgoing Correspondence* (Oct. 25, 2007).

50 *Id.*

51 For a detailed discussion of the National Taxpayer Advocate's concerns regarding assigning one IRS employee to handle a taxpayer's matter until it is closed, see Most Serious Problem: CORRESPONDENCE EXAMINATION: *The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*, *supra*.

52 Pacific Consulting Group, *Compliance Center Examination (CC Exam) SB/SE National Report, January Through March 2008* (July 2008).

53 IRM 4.19.19.2(17), *Call Requirements* (Mar. 28, 2013).

54 *Id.*

55 Phone Optimization Project (POP) Team Recommendations, *Solutions to Improve Taxpayer Satisfaction in Correspondence Examination Briefing Document* (June 21, 2010).

specific issues in the audits.<sup>56</sup> Repeat calls for the same issue creates rework for the IRS and contributes to taxpayer frustration.

### *Lack of Specific Employee Contact During Correspondence Exams May Contribute to Taxpayer Burden and Dissatisfaction.*

While correspondence exams and automation of the examination process allow the IRS to conduct many additional exams, the IRS must balance technology with customer service. Taxpayers fare worse in correspondence exams than in field or office audits.

Correspondence exams have lower “agreed to” rates, where the taxpayer accepts the IRS’s findings, than field and office exams. Only about 26 percent of correspondence exams were closed as “agreed to” in comparison to almost 63 percent of field and office exams.<sup>57</sup> This may be due in part to difficulty in communicating with an anonymous examiner who may have drafted letters specifically requesting information or informing the taxpayer of decisions that do not include his or her contact information.

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Sixty-two percent of calls received in the IRS correspondence examination unit are from repeat callers, which may indicate that taxpayers are not receiving the assistance they require, and their calls are being handled inadequately by employees unfamiliar with the specific issues in the audits.

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### **The Lack of Contact Information for a Specific IRS Employee Knowledgeable About and Accountable for the Correspondence Sent to the Taxpayer Violates Taxpayer Rights.**

Failing to include the contact information of an employee with whom the taxpayer may discuss his case violates the *right to quality service*, the *right to be informed*, and the *right to a fair and just tax system* contained in the Taxpayer Bill of Rights.<sup>58</sup> The *right to quality service* should ensure that a taxpayer can reach an employee who is knowledgeable about his or her case, preferably the same employee each time, to resolve the issue timely and with the least burden to the taxpayer.

Taxpayers have the *right to be informed* in clear and easily understandable language about actions taken on their accounts and to have an employee familiar with the case provide the explanation the taxpayer requires. Under the *right to a fair and just tax system*, taxpayers have the right to have information particular to their situations considered in resolving account issues. When a taxpayer does not know who to contact and cannot reach the employee who made a preliminary determination or requested additional information from them, they may need to explain their issue multiple times to different employees and may receive different responses each time.

<sup>56</sup> See IRS, *Phone Optimization Project (POP), POP to the TOP Phone Enhancement Training Participant Guide 1* (2009) (cited by National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 80). See also Treasury Inspector General for Tax Administration, Ref. No. 2012-30-093, *Improved Toll-Free Telephone Services Should Make It Easier for Taxpayers to Obtain Assistance During a Correspondence Audit 1* (Aug. 17, 2012). The IRS has not performed any follow-up studies for this measurement. IRS response to TAS information request (Sept. 5, 2014).

<sup>57</sup> IRS, CDW, Audit Information Management System (AIMS) Closed Case Database FY 2014 (Nov. 20, 2014). The IRS closed 26.2 percent of correspondence exams as agreed and 62.9 percent of field and office exams as agreed in FY 2014.

<sup>58</sup> IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

## CONCLUSION

While technological advances have permitted the IRS to automatically generate and send many notices and letters to taxpayers that were previously sent by employees, the IRS must strike a balance between technology and customer service. Given the volume of notices issued by the IRS and the technology that allows the IRS to automatically identify many errors in tax returns, it would be impractical to assign an employee to every piece of correspondence. However, where an actual employee has looked at a taxpayer's account and made a decision about that account, that employee's name and specific contact information should appear on the notice that communicates that decision. Contact information should also be provided where an employee has looked at a case as a result of taxpayer correspondence or phone calls. Failing to include specific contact information for employees on such notices puts the IRS right back to where it was when Senator Domenici could not believe that a statute had to be passed to accomplish such a basic task.<sup>59</sup>

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that:

1. All audit notices and correspondence currently sent to taxpayers, including those generated by Examination software, should be reviewed to ensure compliance with § 3705(a) of RRA 98.
2. Where an employee has reviewed a case, letters generated by that review should contain the employee's name and contact information even if the letter is generated with the assistance of automated systems or software.
3. If a notice is generated automatically through a program such as ACE, but has legal impact on the taxpayer, such as a Statutory Notice of Deficiency (SNOD), the contact information for a manager should be included on such notices to facilitate call-routing and case assignment.
4. Once a taxpayer has communicated with the IRS, either by correspondence or via a phone call, contact information for the employee who reviews that correspondence or answers the telephone call should appear on subsequent correspondence.

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59 144 CONG. REC. S7717-04 (1998) (statement of Sen. Domenici).

MSP  
#15**VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services****RESPONSIBLE OFFICIALS**

John M. Dalrymple, Deputy Commissioner, Services and Enforcement  
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 Kirsten B. Wielobob, Chief, Appeals

**DEFINITION OF PROBLEM**

Over 15 years ago, Congress recognized the opportunities for effective tax administration presented by videoconferencing and similar technologies.<sup>1</sup> As a result, in RRA 98, Congress directed the IRS to “consider the use of the videoconferencing of appeals conferences between appeals officers and taxpayers seeking appeals in rural or remote areas.”<sup>2</sup>

Virtual service delivery (VSD) is an indispensable means of facilitating such important taxpayer rights as *the right to quality service, the right to challenge the IRS’s position and be heard, and the right to a fair and just tax system.*<sup>3</sup> The National Taxpayer Advocate has consistently championed VSD’s benefits, including:

- The ability to transmit and discuss documents in real time;
- The improvement of communication and interaction between the IRS and taxpayers; and
- The reduction of costs for all parties.<sup>4</sup>

Without access to VSD, taxpayers living in remote areas and in states where no Appeals or Settlement Officers are present have limited options for obtaining face-to-face interactions with IRS personnel, which can be especially important in communicating complex matters, raising objections, providing additional documentation, and assessing credibility. Face-to-face interactions have been shown to enhance taxpayer

1 Hereafter referred to collectively as “virtual service delivery” (VSD).

2 Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, Title III, Subtitle E, § 3465(c) (July 22, 1998).

3 National Taxpayer Advocate 2013 Annual Report to Congress 5-19. To its great credit, the IRS on June 10, 2014, adopted the Taxpayer Bill of Rights (TBOR) that the National Taxpayer Advocate has long recommended, pulling together in one basic statement the substantive rights scattered throughout the Internal Revenue Code. See IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

4 See, e.g., National Taxpayer Advocate 2012 Annual Report to Congress 462-68; National Taxpayer Advocate 2012 Annual Report to Congress 302-18.

satisfaction and to increase taxpayer responsiveness during audits.<sup>5</sup> Despite these clear benefits and some initial steps by the IRS to implement this technology, the IRS has not yet developed a comprehensive approach to virtual service delivery, in either brick and mortar locations or over the Internet.<sup>6</sup>

## ANALYSIS OF PROBLEM

In passing RRA 98, Congress envisioned the increased use of technology, including VSD, as a means of improving taxpayers' experience with the IRS.

The National Commission on Restructuring the IRS (Restructuring Commission) contemplated a new IRS operating like a customer-focused business, as competently and smoothly as a bank, credit card company, or utility.<sup>7</sup> The Restructuring Commission recognized that skillful use of enhanced technology would be a key element of this service model, which emphasized efficiency and customer focus.<sup>8</sup>

The IRS must update its technology and treat taxpayer information as a strategic asset to improve its customer service and compliance functions ... Advancements in technology will make it easier for the IRS to resolve taxpayer problems quickly, thereby reducing the intrusiveness of the government.<sup>9</sup>

Reflecting this vision, Senator Roth, Chair of the Senate Finance Committee, articulated some of the goals underlying the legislation as making "IRS employees more accountable," giving "the Commissioner the tools necessary to bring the IRS into the next century," and offering "greater due process to taxpayers who are trying to comply with our complex tax laws."<sup>10</sup> In furtherance of these goals, the Committee instructed that "[t]he Commissioner of Internal Revenue shall consider the use of the videoconferencing of appeals conferences between appeals officers and taxpayers seeking appeals in rural or remote areas."<sup>11</sup>

### Other government agencies, such as the Social Security Administration (SSA) and the Department of Veterans Affairs (VA), have improved and enhanced their services through VSD.

Like the IRS, the SSA and the VA are charged with fulfilling widespread customer service obligations in an environment of contracting financial resources. These agencies have made substantial progress in employing videoconferencing to reduce wait times and improve accessibility for those who reside in remote locations or have critical needs.

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- 5 IRS National Research Program 2011 Customer Satisfaction Survey (Feb. 9, 2012); National Taxpayer Advocate, Briefing for the Enforcement Committee, *Examination Strategy: The Impact of Increasing Automation*, slide 15 (Apr. 23, 2012). In addition to options presented by virtual face-to-face technology, the availability of in-person interactions should always be preserved. For a more in-depth discussion regarding the importance of in-person interactions between taxpayers and the IRS, see *Most Serious Problem: APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *supra*. See also *Legislative Recommendation: ACCESS TO APPEALS: Require That Appeals Have at Least One Appeals Officer and Settlement Officer Located and Permanently Available Within Every State, the District of Columbia, and Puerto Rico*, *infra*.
- 6 For a suggestion from the National Taxpayer Advocate regarding congressional intervention as a means of solving this problem, see *Legislative Recommendation: Virtual Service Delivery (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet*, *infra*.
- 7 Report of the National Commission on Restructuring the IRS, 8 (June 25, 1997). RRA 98 was based on the Commission's findings and recommendations.
- 8 *Id.* at 6.
- 9 *Id.*
- 10 144 CONG. REC. S4182 (1998) (Remarks by Senator Roth).
- 11 RRA 98, Pub. L. No. 105-206, Title III, Subtitle E, § 3465(c) (July 22, 1998).

Eighty-three percent of taxpayers responding to an IRS study indicated they were likely to use the IRS website, while 72 percent said they probably would use email to send questions directly to the IRS. Further, over half of the respondents (53 percent) stated they would be likely to use two-way video communications.

Employing over 400 video units in field offices across the country, the SSA completed over 70,000 video calls and more than 115,000 video interviews with field office customers between July 2011 and July 2012.<sup>12</sup> Moreover, in 2012, SSA held almost 25 percent of its hearings by video, compared to less than five percent in 2004.<sup>13</sup>

The VA uses videoconferencing for a variety of applications ranging from primary care treatment to speech pathology services to mental health support.<sup>14</sup> Generally, the health services are delivered to community-based outpatient clinics (CBOC) from traditional VA health care facilities by clinical videoconferencing equipment using highly encrypted transmissions.<sup>15</sup> The VA operates over 700 CBOCs with videoconferencing capacity for veterans who lack easy access to VA hospitals.<sup>16</sup> The VA provided approximately 140,000 remote mental health visits alone to approximately 55,000 veterans in fiscal year (FY) 2011.<sup>17</sup>

### The potential benefits of videoconferencing in brick and mortar locations and over the Internet have yet to materialize for either taxpayers or the IRS.

Notwithstanding the insights of the Restructuring Commission, the directives of RRA 98, and the success of other agencies, the IRS is still operating as a 20th century business, primarily relying on postal correspondence, telephone conversations, and taxpayer visits to brick and mortar locations.<sup>18</sup> This model places unnecessary limits on the accessibility of the IRS, along with the types of interactions that are available, and is increasingly costly to administer.

Extended delays surrounding correspondence with the IRS, lengthy hold times when telephoning for IRS assistance and long lines at Taxpayer Assistance Centers (TACs) have combined to frustrate and anger taxpayers.<sup>19</sup> These shortcomings in taxpayer services run counter to the Congressional intent underlying RRA 98, but can be mitigated to the extent that the IRS makes effective use of VSD. Societal comfort

12 See Social Security Administration, *Service Delivery Plan*, 14-15 (Feb. 20, 2013), available at [www.ssa.gov/open/SDP/SDP\\_022013.pdf](http://www.ssa.gov/open/SDP/SDP_022013.pdf).

13 *Id.*

14 See Real-Time Clinic Based Video Telehealth (Jan. 16, 2014), available at <http://www.telehealth.va.gov/real-time/index.asp>.

15 Deen, Godleski, and Fortney, *A Description of Telemental Health Services Provided by the Veterans Health Administration in 2006–2010*, 63 PSYCHIATRIC SERV. No. 11 (Nov. 1, 2012), available at <http://journals.psychiatryonline.org/article.aspx?articleid=1386903>; For Veterans with PTSD, *Videoconferencing Proves Effective for Delivering Therapy*, VA RESEARCH CURRENTS, May 2013, available at <http://www.research.va.gov/currents/may13/may13-02.cfm>.

16 See Real-Time Clinic Based Video Telehealth (Jan. 16, 2014), available at <http://www.telehealth.va.gov/real-time/index.asp>.

17 *Using Technology to Improve Access to Mental Health Care*, Veterans Health Administration News Features (Aug. 13, 2012), available at <http://www.va.gov/health/newsfeatures/20120813a.asp>.

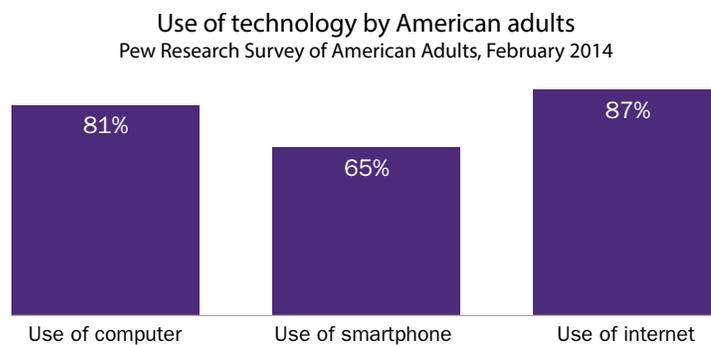
18 The exception to this circumstance is electronic filing of tax returns, the prevalence of which can be directly traced to the Congressional mandate established in RRA 98. See RRA 98, Pub. L. No. 105-206, Title II, Subtitle A, § 2001 (Jul. 22, 1998). Similar progress has not been made in other areas, however. For example, Taxpayer Assistance Centers and the services they offer are contracting rather than expanding. For a more in-depth discussion of this topic, see Most Serious Problem: *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*, *supra*.

19 National Taxpayer Advocate 2013 Annual Report to Congress 20-39; Government Accountability Office, GAO-12-176, *2011 Tax Filing: Processing Gains, but Taxpayer Assistance Could Be Enhanced by More Self-Service Tools* (Jan. 17, 2012).

with computer technology in general, and virtual service delivery in particular, has grown to such a degree that many taxpayers would embrace this option, especially if it saved them time or expense.<sup>20</sup>

The scope of this opportunity is demonstrated in a study conducted by the Pew Research Center's Internet and American Life Project, which indicates that 81 percent of adult Americans use a computer on at least an occasional basis.<sup>21</sup> Further, approximately 65 percent of the individuals surveyed reported having a smartphone. Eighty-seven percent of adult Americans use the Internet occasionally, with 82 percent of the survey respondents stating they had done so within the last day. Ninety percent of this latter group reported going online from home.<sup>22</sup>

**FIGURE 1.15.1**



The IRS Oversight Board has also noted the increased comfort with, and use of, computer technology, and the resulting opportunities for VSD. Eighty-three percent of taxpayers responding to an IRS study indicated they were likely to use the IRS website, while 72 percent said they probably would use email to send questions directly to the IRS.<sup>23</sup> Further, over half of the respondents (53 percent) stated they would be likely to use two-way video communications.<sup>24</sup> As summarized by the study, “[r]esults show indications of upward trends in the likely use of these more technology-based service options.”<sup>25</sup> This openness to the use of computer technology is illustrated in the following chart.

20 U.S. taxpayers living abroad would particularly benefit from the ability to utilize virtual face-to-face technology as a means of interacting with the IRS. See National Taxpayer Advocate 2012 Annual Report to Congress, 462-68.

21 Pew Research Center, *The Web at 25 in the U.S.* (Feb. 27, 2014) (conducted January 2013) available at <http://www.pewinternet.org/2014/02/25/the-web-at-25-in-the-u-s>.

22 *Id.*

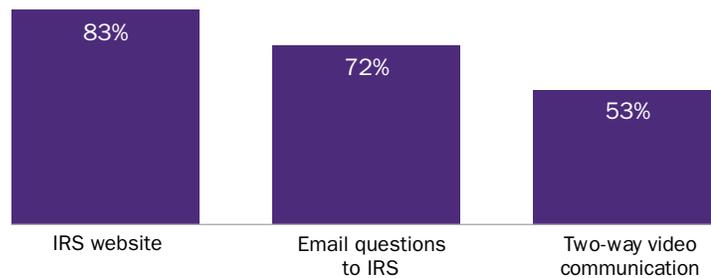
23 IRS Oversight Board, *2013 Taxpayer Attitude Survey* (conducted Aug. 2013), available at [http://www.treasury.gov/IRSOB/reports/Documents/IRSOB\\_TAS%202013.pdf](http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_TAS%202013.pdf).

24 *Id.*

25 *Id.*

FIGURE 1.15.2

Willingness to use technology by American adults  
IRS Oversight Board Survey of Taxpayers, February 2014



In passing RRA 98, Congress urged the IRS to adopt a course of action that likely would have yielded VSD progress comparable to that achieved by the SSA and the VA. Although Congress articulated the desired VSD exploration in the context of Appeals, technological innovation on that front presumably would have migrated to other IRS divisions. More than 15 years after the enactment of RRA 98, however, the desire reflected in and the opportunity presented by Congress' videoconferencing directive have yet to be achieved. The IRS is taking strides toward making the benefits of VSD available to taxpayers, but the potential and need for substantial and necessary progress remain.

*VSD represents an important means of expanding the reach of brick and mortar locations.*

The most traditional type of VSD is associated with a public facility, such as a TAC, and employs a high-definition monitor with the capacity for two-way audio interchange between the taxpayer and the IRS. In some locations, the monitor is paired with a high-resolution camera that allows IRS personnel to view documentation provided by taxpayers. That equipment, which is hard-wired into a given facility, provides secure connectivity between taxpayers and the IRS.

A significant impediment to the growth of VSD use in such facilities, however, is the limited activity that can be undertaken by taxpayers in conjunction with videoconferencing. Taxpayers generally cannot:

- Fax or otherwise electronically submit documents;<sup>26</sup>
- Make payments;
- File returns; or
- Obtain account transcripts.<sup>27</sup>

26 Eight VSD Partner Sites are outfitted with physical fax machines that can send and receive faxes. User & Network Services (Network Services) supplemental response to TAS research request (Aug. 25, 2014).

27 *Id.* Taxpayers using VSD to speak with TAS can obtain all the services they would be able to receive in any TAS field office where face-to-face contact is offered, with the exception of making a payment. Additionally, four TAS Campus offices provide VSD assistance to remote taxpayers. For security reasons, taxpayers are not allowed to walk into IRS Campuses. Nevertheless, VSD provides a mechanism for TAS customers to obtain face-to-face assistance from TAS employees located in campus offices who would not otherwise be accessible.

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**Societal comfort with computer technology in general, and virtual service delivery in particular, has grown to such a degree that many taxpayers would embrace this option, especially if it saved them time or expense.**

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The IRS is exploring technology that will allow taxpayers to accomplish these and other routine tasks, with multiple IRS organizations sharing the technology and routing video to the correct location.<sup>28</sup> Nevertheless, until the IRS develops such expanded capacity, taxpayers will be less likely to embrace videoconferencing in brick and mortar locations.

The IRS has installed videoconferencing technology at only 49 taxpayer-facing locations around the country.<sup>29</sup> As this relatively small number of locations would indicate, videoconferencing still exists within the IRS largely on a conceptual basis, rather than as a day-to-day mechanism for serving customers. Despite positive initial results, the IRS has not yet moved beyond the piloting phase of videoconferencing on a large scale.<sup>30</sup> Of the 49 locations currently outfitted for videoconferencing, only 37 appear to offer such services to taxpayers on an ongoing day-to-day basis, with the remaining 12 reporting zero taxpayers served for FY 2014.<sup>31</sup>

This relatively slow progress is attributable to a variety of obstacles. Currently, videoconferencing does not take place within the IRS firewall, which limits the use of the equipment and does not allow the IRS to fully utilize its functionality.<sup>32</sup> Because of concerns about data security, no information personally identifiable to taxpayers can be transferred on the network now in operation.<sup>33</sup>

On the human capital end of the spectrum, the IRS has also experienced difficulty in staffing the videoconferencing facilities, which require at least some personnel coverage for opening and closing the facility, maintaining the equipment, and answering essential questions regarding its operation. Often the most desirable facilities are, by definition, in remote areas, where the IRS has encountered challenges in finding employees who are available and willing to staff these sites consistently.

As in so many areas, insufficient funding is a contributing cause of the IRS's inability to move more quickly in this aspect of taxpayer service. The IRS budget for FY 2014 originally requested approximately \$4,000,000 for the deployment of 100 new videoconferencing units.<sup>34</sup> Ultimately, however, nothing was allocated, and no VSD funding is expected to be available for FY 2015 or beyond.<sup>35</sup>

The IRS has shifted much of its emphasis to the provision of VSD over the Internet. Nevertheless, the continued development of VSD in brick and mortar locations is essential for taxpayer populations that do not have access to home computer technology or who are not proficient in its use. The requisite

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28 National Taxpayer Advocate 2012 Annual Report to Congress 465.

29 Network Services response to TAS research request (Aug. 6, 2014).

30 *E.g.*, in a limited pilot conducted by W&I between October 2011 and June 2012, 87 percent of taxpayers reported they were satisfied, to very satisfied, with this service, and 91 percent would use it again. W&I Response to TAS Fact Check Request (Nov. 4, 2014).

31 Network Services response to TAS research request (Aug. 6, 2014).

32 *Id.*

33 *Id.*

34 Dep't of the Treasury, *Budget in Brief, Internal Revenue Service, FY 2014*, 10, Doc. 9940 (Rev. 4-2013).

35 Network Services response to TAS research request (Aug. 6, 2014).

maintenance and expansion of traditional VSD, however, cannot occur in the absence of sufficient funding, which has yet to be provided by Congress or shifted from other programs within the IRS.<sup>36</sup>

The IRS should begin employing all of its videoconferencing-enabled locations on a day-to-day basis. For example, Appeals has had a number of videoconferencing-ready locations that did not “go live” until near the end of the 2014 fiscal year.<sup>37</sup> Additionally, the IRS can achieve substantial strides by enhancing the scope of activities that can be undertaken by taxpayers in conjunction with videoconferencing. The increased utilization resulting from expanded functionality will not only establish the value proposition of VSD with respect to the IRS, but also will help demonstrate the benefits and existence of videoconferencing facilities to taxpayers.

As a further means of maximizing the efficient provision of VSD, the Treasury Inspector General for Tax Administration (TIGTA) has suggested that the IRS establish a process to identify the best locations for VSD, without limiting the inquiry to those sites where TACs already exist.<sup>38</sup> The need for strategic location of VSD sites, together with personnel who can provide appropriate assistance, is especially great for low-income populations that may lack the technological skills or comfort level to fully utilize the benefits of VSD.<sup>39</sup> As a result, the IRS should seek additional opportunities to partner with local organizations and government agencies, such as the U.S. Postal Service, as a cost-effective way of bringing VSD and the necessary staffing to all taxpayers.<sup>40</sup>

*VSD over the Internet presents a separate approach with enormous potential benefits for both taxpayers and the IRS.*

The provision of VSD at brick and mortar locations will always have its place as a means of assisting taxpayers who lack home computing facilities or capabilities. Nevertheless, the bulk of U.S. taxpayers and

36 Also recognizing the value of VSD, TIGTA has recommended that the IRS develop a long-term plan to provide virtual face-to-face assistance to as many taxpayers as possible through the use of VSD in brick and mortar locations. TIGTA has further recommended that the cost savings and benefits related to VSD be quantified and reported as part of the budget request process. TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 27, 2014).

37 To its credit, Appeals has established procedures for making VSD available for Campus Appeals in situations where Appeals personnel are co-located with VSD equipment and the taxpayer or representative is located within 100 miles of a VSD taxpayer-facing location. See Memorandum for Appeals Employees, *Implementation of Virtual Service Delivery*, John Cardone, Director, Policy, Quality and Case Support (July 24, 2014). To this point, however, the lack of customer-facing locations that are publicized and available places a significant limitation on the ability of taxpayers to utilize this option. As these locations did not come online until September 29, 2014, TAS cannot currently evaluate the extent to which taxpayers are encouraged and able to utilize this technology. See Appeals’ Response to TAS Fact Check Request (Nov. 3, 2014).

38 TIGTA, Ref. No. 2014-40-038, *Processes to Determine Optimal Face-to-Face Taxpayer Services, Locations, and Virtual Services Have Not Been Established* (June 27, 2014).

39 A Taxpayer Advocate Service study of taxpayers eligible to use low-income tax clinics (LITCs) indicated, among other things, that although 70 percent of the taxpayers surveyed had a computer with an internet connection at home, only 13 percent of LITC-eligible taxpayers reported they would feel comfortable discussing their income tax situation by video from a designated location with an assigned IRS representative. Only 25 percent of Spanish-speaking taxpayers said they would feel comfortable holding such a videoconference. See TAS Survey of Taxpayers Eligible to use LITCs conducted by Russell Research (July 2014). These results reinforce the caution previously articulated by the National Taxpayer Advocate that VSD should not be viewed as a replacement for face-to-face conferences, which were preferred by 77 percent of the LITC-eligible taxpayers. Similarly, the results suggest that the availability of personal instruction and guidance with respect to VSD equipment likely is an important element of full utilization of that equipment even by a segment of those taxpayers possessing computer and internet-capability at home.

40 Mobile van units represent an additional potential means of bringing technology directly to taxpayers, particularly those located in low-income and rural areas. For a more in-depth discussion of this topic, see *Most Serious Problem: IRS Local Presence: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS’s Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

all tax professionals likely would interact with the IRS via home or office computer or smartphone if they had the chance, just as they now do with a wide range of businesses and related enterprises.

As a result, the IRS is also attempting to develop a comprehensive, Internet-based VSD platform that taxpayers can access using their own technology. Central to this initiative, known as taxpayer digital communications (TDC), is a secure messaging portal. This portal would provide taxpayers with web access to certain functionalities including one-way/two-way communication via secure webmail, and electronic document upload, transfer, and receipt capacity.<sup>41</sup> Later in the TDC development process, taxpayers would have online text chat, click to call, online video meeting, and co-browsing capability.<sup>42</sup> Ultimately, taxpayers also would be able to undertake most of these interactions with the IRS directly from their smartphones.<sup>43</sup>

Virtually all of this TDC functionality, however, is aspirational, as many of the platform features are still in the planning stage. Only the secure messaging capability, which is scheduled to begin piloting in FY 2015, is nearing release and procedures for secure authentication are still under discussion.<sup>44</sup> The IRS has no estimate for when the other functionalities will become available.<sup>45</sup> Widespread interchange between taxpayers and the IRS via smartphone remains a goal, but without definitive parameters or timetables.<sup>46</sup>

TDC has vast potential for delivering services to taxpayers in ways that are more accessible, convenient, and cost effective for taxpayers. Moreover, the use of such technology can revolutionize tax administration in terms of resource allocation, cost savings, and enhanced quality of service. Such benefits, both to taxpayers and to the IRS, are fully consistent with Congress' vision expressed in RRA 98 in general, and in § 3465(c) in particular.

The IRS is to be commended for its recent efforts in this regard. Nevertheless, substantial progress remains to be made and the National Taxpayer Advocate urges that continued development and implementation of TDC be a high priority of the IRS.

## CONCLUSION

As an element of RRA 98, Congress envisioned the increased use of technology, including VSD, as a means of improving taxpayers' experience with the IRS. More than ever, taxpayers and the IRS would benefit from the cost-savings and improved customer service that would be generated by VSD. Other governmental agencies, such as the SSA and the VA, have had notable success in improving and enhancing customer services through the implementation of VSD. Such benefits, however, have not yet materialized for taxpayers and the IRS either through the provision of videoconferencing in brick and mortar locations or through the use of TDC.

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41 Online Services (OLS) response to TAS research request (Aug. 18, 2014).

42 OLS: Taxpayer Digital Communications Executive Summary (Aug. 18, 2014).

43 OLS response to TAS research request (Aug. 18, 2014).

44 *Id.* As currently formulated, these secure authentication procedures could potentially exclude taxpayers who do not have a bank account or who do not own a home from access to TDC. TAS looks forward to continued collaboration with OLS and other stakeholders to develop an effective and inclusive authentication mechanism that works for all taxpayers.

45 *Id.*

46 *Id.* SB/SE Field Collection has recently initiated a Smartphone pilot in its Tampa, FL and Oakland, CA Territories. Eventually, SB/SE Field Collection plans to have Revenue officers use Smartphones to facilitate activities such as electronic payment and GPS Mapping. See Smartphone Technology – The Wave of the Future for the IRS (Sept. 17, 2014) available at <http://www.mysbse.web.irs.gov/default.aspx>.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Maximize the benefits of VSD in brick and mortar locations currently equipped for videoconferencing by offering VSD services from all such facilities on a day-to-day basis and by enhancing the scope of activities that taxpayers can undertake in conjunction with videoconferencing.
2. Establish development and implementation of TDC as one of its highest ongoing priorities.
3. Develop and publish a definitive plan for the continued rollout of both VSD in brick and mortar locations, including non-IRS facilities, and TDC, and articulate concrete dates for implementation at different stages.
4. Allocate funding, or seek funding from Congress, sufficient to enable continued implementation of VSD initiatives in brick and mortar locations and over the Internet.

**MSP  
#16****MATH ERROR NOTICES: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

Under Internal Revenue Code (IRC) § 6213(b) and (g), the IRS is authorized, in specific instances, to assess tax without first issuing the statutory notice of deficiency (SNOD) that allows taxpayers access to the prepayment forum of the U.S. Tax Court. Previously this provision applied only to mathematical errors (*e.g.*,  $2 + 2 = 5$ ).<sup>1</sup> In 1976, acting on a request made by the IRS, Congress expanded math errors to include “clerical errors” (*e.g.*, inconsistent entries).<sup>2</sup>

Congress was concerned about granting the IRS this expanded authority and specifically directed that when the IRS makes a summary assessment for a mathematical error, the taxpayer must be given an explanation of the adjustment.<sup>3</sup> The explanation of the adjustment in the math error notice is critical to the taxpayer’s ability to challenge the adjustment and preserve his or her right to petition the U.S. Tax Court by requesting abatement within 60 days of the notice being sent.<sup>4</sup>

Although nearly four decades have passed since Congress instructed the IRS to explain math error adjustments to taxpayers, the explanations are often unclear, complex, and leave taxpayers confused. This makes it difficult for taxpayers to determine what, specifically, has been corrected on their returns and whether they should accept the adjustment or request a correction. Such confusion may drive the taxpayers to seek clarification of the notice by calling the IRS. However, reaching an employee might take days, since Accounts Management,<sup>5</sup> the IRS function responsible for answering these calls, answers less than two-thirds of incoming calls, thereby using at least a portion of the taxpayer’s 60 days to request an abatement of the adjusted tax.<sup>6</sup>

When the explanation of the math error adjustment is unclear, and the taxpayer spends valuable time seeking further guidance, the taxpayer’s *right to appeal an IRS decision in an independent forum* and the *right to be informed* are compromised, and the *right to challenge the IRS’s position and be heard* may be

1 Revenue Act of 1926, enacting IRC § 274(f). See H.R. Rep. No. 69-1, at 10-11 (1926).

2 Pub. L. No. 94-455, § 1206(b) (1976), enacting IRC § 6213(f)(2).

3 S. Rep. No. 94-658, 94th Cong., 2d Sess. 375 (1976); H. Rep. No. 94-658, 94th Cong., 2d Sess. 289 (1976).

4 IRC § 6213(b).

5 Internal Revenue Manual (IRM) 21.1.1.2, *Accounts Management Responsibilities* (Oct. 2014). The Accounts Management organization is responsible for taxpayer relations by answering tax law/account inquiries and adjusting tax accounts. In addition, it is responsible for providing taxpayers with information on the status of their returns/refunds, and for resolving the majority of issues and questions to settle their accounts.

6 Joint Operations Center (JOC), *Enterprise Snapshot Report*, FY 2014 (Oct. 16, 2014) (showing 64.39 percent Level of Service). In some cases the IRS has authority to make abatements on requests beyond the 60-day statutory period. See generally IRM 21.5.4, *General Math Error Procedures* (Oct. 1, 2014).

lost.<sup>7</sup> These problems may be compounded as further expansions of IRS math error authority are proposed, making it even more important for math error notices to follow the 1976 congressional directive.<sup>8</sup>

## ANALYSIS OF PROBLEM

### Background

#### *Deficiency Procedures*

Generally when the IRS identifies an error on a taxpayer's return that will result in an understatement of tax, the IRS notifies the taxpayer of the proposed deficiency. It first provides the taxpayer with a report, including the items to be adjusted and the tax, if any, reported on the original return and the correct tax according to the IRS. The taxpayer has 30 days to accept this proposed adjustment or request an administrative appeals conference with an Appeals Officer.<sup>9</sup>

If the taxpayer does not respond to the initial report, or does not prevail in the appeals conference, the IRS will issue a SNOD that sets forth the proposed deficiency in tax. It informs the taxpayer that he or she has 90 days from the date of the notice to file a petition to challenge the proposed deficiency in the U.S. Tax Court, the only judicial forum in which a taxpayer can challenge a tax liability before paying the liability in full.<sup>10</sup> The SNOD provides important procedural rights and protections. If the taxpayer does not timely file a petition with the Tax Court, the IRS will assess the proposed deficiency.<sup>11</sup>

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The explanation of the adjustment in the math error notice is critical to the taxpayer's ability to challenge the adjustment and preserve his or her right to petition the U.S. Tax Court by requesting abatement within 60 days of the notice being sent.

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#### *Mathematical or Clerical Error Procedures*

Congress has given the IRS authority to circumvent these normal deficiency procedures in certain circumstances. IRC § 6213(b) authorizes the IRS to make a summary assessment of tax due where that addition is the result of a mathematical or clerical error on a return. To make this summary assessment, the IRS must explain the error to the taxpayer.<sup>12</sup> The taxpayer has 60 days from the date of the notice to request that the IRS abate the tax.<sup>13</sup> The IRS cannot begin to collect the tax due until the taxpayer has agreed to it or until the 60 days have passed.<sup>14</sup> If the taxpayer requests the tax be abated, the IRS must first use the deficiency procedures under IRC § 6212, described above, to increase the tax shown on the return.<sup>15</sup> It is also the

7 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014). Unclear notices may undermine the following taxpayer rights: the right to be informed, the right to pay no more than the correct amount of tax, the right to challenge the IRS's position and be heard, the right to privacy, and the right to a fair and just tax system.

8 IRC §§ 45R and 36C, and IRS Briefing, *Overview of the Accelerated Refund Assurance Program (ARAP)* (Oct. 6, 2011), on file with TAS. This briefing sets out areas where the IRS is considering requesting Congressional expansion of its math error authority. See also General Explanation of the Administration's Fiscal Year 2015 Revenue Proposals, Department of Treasury Greenbook (Mar. 2014), available at [http://www.treasury.gov/resource-center/tax-policy/Pages/general\\_explanation.aspx](http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx).

9 See IRS Publication 3498-A, *The Examination Process (Audits by Mail)* (Jan. 2014), available at <http://www.irs.gov/pub/irs-pdf/p3498a.pdf>. For times for requesting appeals conferences, see SERP IRM 4.19.13.14.2(2), *Transfer to Appeals* (Aug. 29, 2014).

10 IRC § 6213(a).

11 *Id.*

12 IRC § 6213(b)(1).

13 IRC § 6213(b)(2)(A).

14 IRC § 6213(b)(2)(B).

15 IRC § 6213(b)(2)(A).

only way for the taxpayer to preserve the right to challenge the adjustment in the Tax Court—the only prepayment judicial forum.<sup>16</sup>

### *The History of Math Error Authority*

Math error authority was first granted in 1926, when Congress authorized the Commissioner to make an assessment and collect the tax due because of a mathematical error that was apparent on the face of the return. This authorization also denied the taxpayer a right to appeal to the Board of Tax Appeals without defining what “mathematical error” means.<sup>17</sup> However, the courts generally limited the scope of math error authority to arithmetic errors.<sup>18</sup>

In 1976, Congress expanded the summary assessment authority to include clerical errors in addition to mathematical errors. The Tax Reform Act of 1976 set forth for the first time a definition of the phrase “mathematical or clerical error:”

- An error in adding or subtracting on the return;
- An incorrect use of a table related to the return;
- Inconsistent entries on the same return;
- Omitted information that is required to substantiate an entry on the return; and
- An entry that claims a deduction or credit amount in excess of the statutory limit, where that limit is described as a specific monetary amount or as a percentage, ratio or fraction.<sup>19</sup>

The House Ways and Means Committee noted that these changes were in response to IRS’s request to expand math error authority. The IRS justified this request by explaining that expanded authority would be useful, because the deficiency notice procedure was significantly more costly than the math error procedure, in terms of personnel and processing costs, as well as in collection delay costs.<sup>20</sup>

While understanding the IRS’s justification for requesting expansion of its summary assessment authority, the Joint Committee on Taxation explained Congress’ concerns about removing more situations from the deficiency procedures and placing them under the summary assessment procedures.<sup>21</sup> To address concerns raised by both the Joint Committee on Taxation and the Senate, Congress enacted IRC § 6213(b)(1),

<sup>16</sup> IRC § 6213(b)(1).

<sup>17</sup> Revenue Act of 1926, enacting IRC § 274(f). See also H.R. Rep. 69-1, at 10-11. The U.S. Tax Court was originally established in 1924 as the Board of Tax Appeals. Revenue Act of 1924, ch. 234 §§ 900(a), (k), 43 Stat. 336, 338. In 1969, the U.S. Tax Court was established as a legislative court under Article 1 of the Constitution. The Tax Reform Act of 1969, Pub. L. No. 91-172, § 951, 83 Stat. 730 (1969).

<sup>18</sup> See, e.g., *Farley v. Scanlon*, 13 A.F.T.R.2d 932, 933 (E.D.N.Y. 1964) (interpreting mathematical error as “an error in computing the tax on what the return itself concedes to be income”); *Repetti v. Jamison*, 131 F. Supp. 626, 628 (N.D. Cal. 1955) (stating “the term... was meant to refer to errors in arithmetic” and noting that “Congress did not provide for a petition by the taxpayer to the Board of Tax Appeals in the case of such error... due to the fact that there can be no dispute as to a matter of arithmetical computation.”).

<sup>19</sup> Pub. L. No. 94-455, § 1206(b) (1976), enacting IRC § 6213(f)(2). See also IRC § 6213(g)(2).

<sup>20</sup> H.R. Rep. 94-658, at 289.

<sup>21</sup> Joint Committee on Taxation, JCT 33-76, Assessments in Case of Mathematical or Clerical Errors (sec. 1206 of the Act and sec. 6213 of the Code) (Dec. 29, 1976). See also H.R. Rep. 94-658, at 289 and S. Rep. No. 94-938(I), 94th Cong., 2d Sess. 375 (1976) (Both provided that the IRS should phrase a notice to the taxpayer regarding inconsistent entries on the returns as to include questions designed to show why the IRS has chosen a particular entry. For example, if the taxpayer enters six exemptions, but then calculates for seven exemptions, the IRS should phrase its notices to show whether the taxpayer indeed is entitled to the greater number of exemptions rather than the lesser number.)

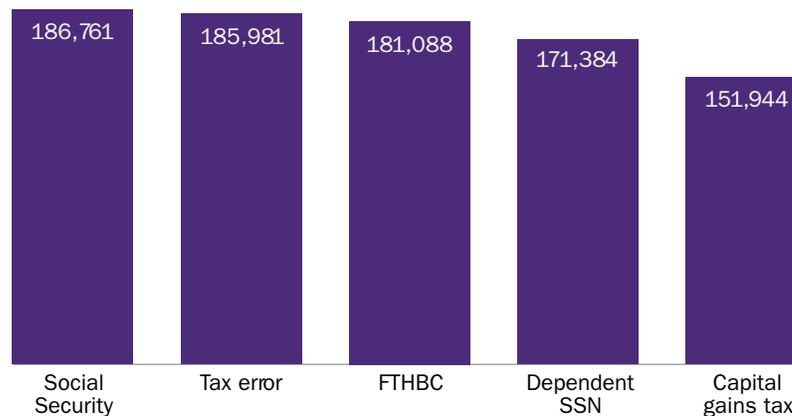
requiring that “[e]ach notice under this paragraph shall set forth the error alleged and an explanation thereof.”<sup>22</sup>

*The IRS Issues Millions of Math Error Notices, Impacting a Large Number of Low Income and Disadvantaged Taxpayers.*

The average annual math error volume from 2008 through 2014 was 7.5 million.<sup>23</sup> Between January 1, 2014 through November 2014, the IRS assigned 2,717,208 math errors to individual taxpayers. The most common adjustments include taxability of Social Security benefits, the First-Time Homebuyer Credit (FTHBC), and mismatches between the dependent’s name and Social Security number. The chart below shows the five most frequently issued math errors.

**FIGURE 1.16.1<sup>24</sup>**

**Most common math errors, January-November 2014**



An analysis of the most common math error adjustments shows the issues are complex and affect a diverse group of taxpayers. Many of these notices are sent to low income taxpayers who often face unique challenges when attempting to understand IRS correspondence. Specifically, between January through November 2014, the IRS mailed over 160,000 Earned Income Tax Credit (EITC) math error notices and over 92,000 Child Tax Credit (CTC) math error notices.<sup>25</sup> The EITC population particularly has a

22 S. Rep. No. 94-938(I), 94th Cong., 2d Sess. 375 (1976). See discussion above in footnote 21, which gives an example from the committee reports of how Congress expected these notices to read.

23 IRS, *Math Error Reports 480-62-11* (2008-2014), totaling over 52,700,000 math errors.

24 See IRS, *Document 6209* (Jan. 2014), at 9-10, describing taxpayer notice codes (TPNC): TPNC 131—We recalculated the taxable amount of your Social Security benefits; TPNC 209—The tax shown on your return was incorrect; TPNC 648—The First-Time Homebuyer Credit Repayment installment was added to your tax; TPNC 605—Because the dependent’s name does not match SSN records, the exemption was disallowed; TPNC 211—The capital gains tax shown on your return was incorrect. For numerical data, see IRS, *Math Error Report* (December 4, 2014).

25 IRS, *Math Error Report* (Dec. 4, 2014). TPNC 285 (Vol. 104,153) and TPNC 743 (55,991) are EITC notices, as are TPNCs 284, 286, 287, 288, 290, 291, 292, 293, 701, 702, 741 and 745; TPNC 251 (25,452), TPNC 252 (46,529), and TPNC 295 (20,417) are CTC or Additional CTC notices.

unique set of attributes, setting these taxpayers apart from the average taxpayer. For example, the average low income taxpayer may have:

- Limited English proficiency;
- Limited computer access;
- Low literacy rates;
- Low education levels; and
- Disabilities.<sup>26</sup>

When considering these variables, low income taxpayers are at higher risk of not understanding the explanation in the notice, and may not know how to challenge the adjustment.

### *Some Math Error Notices Remain Confusing Nearly Four Decades After Congress Directed the IRS to Make Them Clear.*

A TAS review of common math error notices, conducted in conjunction with this critique, has shown that math error notices lack clarity and make it hard for taxpayers to decide whether to accept the adjustment or request abatement. As discussed above, unique characteristics of the low income taxpayer population makes these taxpayers more vulnerable to confusion associated with math error notices. Vague and confusing explanations of math error adjustments may compromise the taxpayer's *right to challenge the IRS's position and be heard* because the taxpayer may be unable to effectively raise objections and provide additional documentation in response to an IRS proposed adjustment. Unclear explanations may also undermine the taxpayer's *right to be informed*, which includes the ability to know what is required to comply with tax laws.<sup>27</sup> Below are several examples of standardized math error explanations that are vague or confusing, and do not ensure that these rights are being adequately protected.

**Example One:** “We limited your total itemized deductions on your Schedule A, *Itemized Deductions*, because certain deductions on Schedule A are limited, if your adjusted gross income is more than the maximum amount.”<sup>28</sup>

This explanation is too vague to be easily understood. It is unclear what on Schedule A is being limited—medical expenses on line 4, miscellaneous expenses, on line 27, or the total amount of itemized deductions, on line 29?

**Example Two:** “We refigured your tax on page 2 of your tax return using the tax table, tax rate schedules, or capital gains tax computations. Because of an error on another part of your tax return we were unable to compute your tax on Form 8615, *Tax for Certain Children Who Have Investment Income*.”<sup>29</sup>

This explanation lacks both clarity and specificity. It does not tell the taxpayer what the error is on the return or even on what part of the return the error is located, and thus leaves the taxpayer to review the entire return in order to locate the error the notice is referencing.

26 See National Taxpayer Advocate 2009 Annual Report to Congress 110 (Most Serious Problem: *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*).

27 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014); Publication 1, *Your Rights as a Taxpayer* (June 2014).

28 TPNC 186 (Document 6209).

29 *Id.*

By contrast, the following example taken from the legislative history illustrates just how clear, specific, and simply worded Congress expected an explanation of a math error assessment to be:

**Example:** A notice regarding an inconsistency in the number of dependents listed on the taxpayer's return might read as follows: "You entered six dependents on line x but listed a total of seven dependents on line y. We are using six. If there is one more, please provide corrected information."<sup>30</sup>

Yet, the IRS's current math error notice for this issue (*i.e.*, inconsistent number of dependents on the return) falls short by not specifying the discrepancy. The current notice states:

We changed your total exemption amount on page 2 of your tax return because there was an error in the number of exemptions provided on lines 6a, 6d, and/or computation of your total exemption amount.<sup>31</sup>

The IRS should organize a team, which would include TAS, to review and rewrite explanations of math error adjustments, where necessary, to ensure congressional intent is being met. This would reduce confusion among taxpayers and save limited IRS resources used for rework associated with unclear notices.

### *Notice Review Procedures Need Improvement to Ensure Clarity and Consistency.*

Math error notices are generally written, updated, and cleared using the same process as any other notice, which involves several layers of review.<sup>32</sup> The Wage and Investment (W&I) Submission Processing Division creates the content for the math error notices, then works with the Office of Taxpayer Correspondence (OTC) to develop the language for each math error notice using plain writing principles. Once the OTC creates a prototype of a notice and the business unit concurs, the notice is sent to the IRS Office of Chief Counsel for legal sufficiency review, and other stakeholders are given the opportunity to review and comment. However, the TPNC review process does not include TAS.<sup>33</sup>

The IRS has not evaluated whether its notice review process results in effective math error notices.<sup>34</sup> The OTC has conducted math error notice studies, but these studies are focused on the rate of taxpayer response after receiving a math error notice and not necessarily on the clarity of the notices. Taxpayers may fail to respond to a math error notice because they do not understand what is being communicated, not because they agree with a math error adjustment. A recent report by the Treasury Inspector General for Tax Administration (TIGTA) showed that the process for reviewing letters and notices does not always ensure that they are written in plain language.<sup>35</sup> Specifically, the report showed that about 50 percent of

30 See H.R. Rep. No. 94-658, 94th Cong., 2nd Sess. (1976). See also Joint Committee on Taxation, JCT 33-76, *Assessments in Case of Mathematical or Clerical Errors* (sec. 1206 of the Act and sec. 6213 of the Code) (Dec. 29, 1976).

31 IRS, *Document 6209* (2014), TPNC 200.

32 IRS response to TAS information request (July 31, 2014).

33 *Id.*

34 W&I has not conducted research studies or taxpayer focus groups to gauge the effectiveness of its notices in explaining the adjustment.

35 See Plain Writing Act of 2010, Pub. L. No. 111-274, 124 Stat. 2861 (2010).

the letters and 66 percent of the notices reviewed were determined not to be clearly written or did not provide sufficient information.<sup>36</sup>

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**When the explanation of the math error adjustment is unclear, and the taxpayer spends valuable time seeking further guidance, the taxpayer's right to appeal an IRS decision in an independent forum and the right to be informed are compromised, and the right to challenge the IRS's position and be heard may be lost.**

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In certain circumstances, when the IRS examiner determines there is no standard explanation to insert in the math error notices for the particular situation, the examiner can insert his or her own explanation of the adjustment.<sup>37</sup> These “*ad hoc*” explanations are not subject to the same review process as the standard ones. While the Internal Revenue Manual provides for a review by a peer of the examiner,<sup>38</sup> without further guidance this limited review may not ensure that the explanation of the adjustment is clear and that similar explanations are provided to taxpayers in similar situations.

Between January 1, 2014, and December 4, 2014, examiners exercised the option to use non-standard explanations 14,477 times.<sup>39</sup> This means that over 14,000 math error explanations that went out to taxpayers, in large part, escaped scrutiny about whether the notice was clear and provided taxpayers with an adequate explanation of the proposed adjustment. Considering that the specified IRM provides examiners no clear instructions on how to write these *ad hoc* explanations,<sup>40</sup> and given the insufficient amount of training IRS employees receive on writing in general, these *ad hoc* explanations may fall short of the directive to provide clear explanations, and may instead confuse taxpayers.<sup>41</sup>

To improve math error notice review procedures the IRS should design and conduct research studies and focus groups with taxpayers that measure taxpayers' understanding of the adjustment. Additionally, the IRM should set forth a template of explanations to be used when an examiner is deviating from a standard explanation. The template could provide an outline of the elements to be included in the explanation, with examples. TAS should be included in the development of such a template.

### *Unclear Math Error Notices May Harm Taxpayers' Ability to Timely Exercise Their Rights.*

Notices that are not clearly written or do not contain sufficient information erode a taxpayers' *right to challenge the IRS's position and be heard*.<sup>42</sup> Specifically, if notices are not simple and clear, taxpayers

36 TIGTA, Ref. No. 2014-40-076, *Processes Are Needed to Ensure that Letters and Notices Are Written in Compliance with the Plain Writing Act* (Sep. 12, 2014). TIGTA's evaluation of statistically valid samples of 18 letters and 38 notices that were revised or redesigned during Fiscal Year 2013 identified that nine (50 percent) of the letters and 25 (66 percent) of the notices are not clearly written and structured or do not provide sufficient information. This report did not focus on math error notices specifically, but its findings are applicable to all IRS notices, including math error notices.

37 See IRM 3.14.1.6.17.12, *Key 100—Non-Standard TPNC Explanations Not Computer Generated* (Jan. 1, 2014) (referencing TPNC 100).

38 See IRM 3.14.1.6.17.12(7), *Key 100—Non-Standard TPNC Explanations Not Computer Generated* (Jan. 1, 2014) (i.e., a cursory quality review within Submission Processing only. Ad hoc notices are not reviewed by the IRS Office of Chief Counsel or the OTC).

39 IRS, *Math Error Report 480-62-11* (Dec. 4, 2014).

40 IRM 3.14.1.6.17.12, *Key 100—Non-Standard TPNC Explanations Not Computer Generated* (Jan. 1, 2014) (referencing TPNC 100). The only guidance provided to examiners on how to develop these *ad hoc* explanations is as follows: “When none of the standard TPNCs adequately describe an error condition on the return, the ERS tax examiner selects TPNC 100 and attaches a 3 x 5 slip of paper containing a specific math error explanation (or a unique number) to the tax return (or ELF print on an electronically filed return).”

41 National Taxpayer Advocate 2013 Annual Report to Congress 40 (Most Serious Problem: *Employee Training: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission*).

42 IRS, *Taxpayer Bill of Rights*, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014).

cannot understand the rationale for the change to their returns and fail to request abatement within 60 days, thereby forfeiting their opportunity to contest the assessment in Tax Court, compromising their *right to appeal an IRS decision in an independent forum*. As a result, affected taxpayers may face IRS collection action.

Additionally, taxpayers can no longer depend on getting through to the IRS's toll-free line within a reasonable amount of time to get a question answered regarding a notice. The level of service (LOS) on Accounts Management's phone lines was less than 65 percent for October 2013 through September 2014.<sup>43</sup> This low level of service makes it difficult for taxpayers to get their questions answered and the abatement requests completed in time. For example, if a taxpayer spends 45 days of the 60-day period trying to get through to the IRS to find out *why* it has assessed additional tax, he or she might not have time to collect needed documentation to request an abatement of the tax within 60 days, ultimately losing access to the Tax Court.<sup>44</sup> This may be particularly harmful to taxpayers for whom a prepayment forum is most critical (*i.e.*, low income taxpayers who cannot afford to pay the tax in full and then file a claim for refund).

Even though the taxpayer is not required to provide documentation to substantiate the abatement request, the option of submitting the request without documentation is not clearly set out in math error notices.<sup>45</sup> Sending the taxpayer a clear initial notice with a simple explanation of the adjustment, and clarifying that the taxpayer can request abatement without supporting documentation, would mitigate the need for the taxpayer to attempt calling the IRS, and would reduce taxpayer burden.

### *Expansion of Math Error Authority Into More Complicated Areas of Tax Law May Further Increase the Challenge for the IRS to Provide Clear Explanations.*

Over the past several years, Congress has expanded the IRS's math error authority to more complicated areas of tax law, such as the Earned Income Tax Credit (EITC) and First-Time Homebuyer Credit (FTHBC), making it more difficult to develop simple explanations of adjustments.<sup>46</sup> This challenge may increase as the President's budget proposal for fiscal year 2015 contains a recommendation that would create an entirely new category called "correctable errors." The passage of this recommendation would permit the IRS to correct errors where:

- The information provided by the taxpayer does not match information in government databases;
- The taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or

43 JOC, Enterprise Snapshot Report, FY 2014 (Oct. 16, 2014).

44 Not all IRS math error notices plainly disclose to taxpayers that the right to contest the assessment may be exercised without submitting proof. See, e.g., IRS Letter CP 12. See also Systemic Advocacy Management System (SAMS) 31192, requesting that IRS disclose IRC § 6213(b)(2)(A) rights in IRS Letter CP 10.

45 See, e.g., IRS Letter CP 12 which states: "If you are unable to provide us additional information that justifies the reversal and we believe the reversal is in error, we will forward your case for audit. This step gives you formal appeal rights, including the right to appeal our decision in court."

46 Besides the five "mathematical or clerical" error types listed in IRC § 6213(g)(2)(A) through (E), math error authority also includes mistakes such as missing Taxpayer Identification Numbers (TINs) for dependency exemptions or EITC, and missing verification of the FTHBC, in IRC § 6213(g)(2)(F) through (P). See National Taxpayer Advocate 2011 Annual Report to Congress 74 (Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*). In the 2011 Annual Report, the National Taxpayer Advocate discussed the challenges expanded math error authority imposes on the IRS and made a legislative recommendation to Congress that would require an IRS analysis, in conjunction with the National Taxpayer Advocate, before any such expansion could be enacted. National Taxpayer Advocate 2011 Annual Report to Congress 524 (Legislative Recommendation: *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights*).

- The taxpayer has failed to include with the return documentation that is required by statute.<sup>47</sup>

This proposal goes beyond the initial grant of mathematical or clerical error authority. With such an expansion of IRS's math error authority a possibility, the need to live up to the original congressional directive regarding clear explanations of adjustments becomes even more critical, because more taxpayers may become subject to the summary assessment procedures.

## CONCLUSION

In 1976, in exchange for granting the IRS expanded math error authority, Congress instructed the IRS to provide taxpayers with an explanation of any math error adjustment. Nearly four decades later, some math error notices remain vague and ambiguous, leaving affected taxpayers confused as to what has been changed on their returns and what they need to do next. Attempting to clarify the notice by calling the IRS toll-free line may take days, since it only answers slightly more than half its calls, thereby eating away at the taxpayer's 60 days to request an abatement of the adjusted tax. Unclear math error notices increase taxpayer burden and jeopardize the taxpayer's *rights to be informed, to challenge the IRS's position and be heard, and to appeal an IRS decision in an independent forum.*

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Organize a team, which would include TAS, to review all current explanations of math error adjustments, and rewrite where necessary, to ensure the congressional directive is being met.
2. Set forth an IRM template for non-standard math error adjustment explanations that provides an outline of the elements to be included in the explanation, with examples. The IRM should also require that these explanations be developed and approved by the OTC, Chief Counsel, and the National Taxpayer Advocate or delegate.
3. Update math error notices to clearly disclose that the taxpayer may request abatement without providing an explanation or substantiating documentation.

<sup>47</sup> General Explanation of the Administration's Fiscal Year 2015 Revenue Proposals, Department of Treasury Greenbook (Mar. 2014), available at [http://www.treasury.gov/resource-center/tax-policy/Pages/general\\_explanation.aspx](http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx).

MSP  
#17**NOTICES: Refund Disallowance Notices Do Not Provide Adequate Explanations****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

The IRS is not providing taxpayers with adequate explanations as to why it is disallowing their refunds as required by the IRS Restructuring and Reform Act of 1998 (RRA 98).<sup>1</sup> Some IRS notices include an explanation that is too short or too vague for the taxpayer to learn the specific reasons for the disallowance.<sup>2</sup> Other explanations are not written in language that the taxpayer can easily understand.<sup>3</sup> Some letters provide no explanation or reason at all, other than stating there is no basis for the IRS to allow the claim or that another notice explaining the disallowance is forthcoming.

In its report on RRA 98, the Joint Committee on Taxation (JCT) stated: “Congress believed that taxpayers are entitled to an explanation of the reason for the disallowance or partial disallowance of a refund claim so that the taxpayer may appropriately respond to the IRS.”<sup>4</sup> A taxpayer’s *right to challenge the IRS’s position and be heard* means taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions.<sup>5</sup> Without an adequate explanation of its actions, taxpayers cannot respond appropriately to the IRS and challenge the disallowance. Taxpayers also have *the right to be informed*, which means the IRS should clearly explain its decisions and the outcomes of its actions. This right is impaired when the IRS disallows a refund without providing a clear, easily understandable explanation to taxpayers. Moreover, vague or inadequate explanations create additional work for the IRS when taxpayers must call or write for clarification.

**ANALYSIS OF PROBLEM****Background***Legislative History and Implementation*

Section 3505 of RRA 98 states, “In the case of a disallowance of a claim for refund, the Secretary shall provide the taxpayer with an explanation for such disallowance.”<sup>6</sup> The legislative history for section 3505 shows Congress intended the IRS to go beyond just a general explanation. In this regard, the

- 1 Section 3505(a) of RRA 98, codified initially at Internal Revenue Code (IRC) § 6402(j) (and then subsequently redesignated as IRC § 6402(l)), states: “In the case of a disallowance of a claim for refund, the Secretary shall provide the taxpayer with an explanation for such disallowance.” Pub. L. No. 105-206, 112 Stat. 685, 771 (1998).
- 2 For example, one 105C letter stated as the explanation: “The information received relating to the case did not change our determination and the case is now closed” (letter on file with TAS).
- 3 The Treasury Inspector General for Tax Administration (TIGTA) reviewed a statistically valid sample of recently revised IRS letters and notices, and found that half of the letters and almost two thirds of the notices were not written clearly or did not provide sufficient information. See TIGTA, Ref. No. 2014-40-076, *Processes Are Needed to Ensure That Letters and Notices Are Written in Compliance with the Plain Writing Act 7* (Sept. 12, 2014).
- 4 JCT, General Explanation of Tax Legislation Enacted in 1998, JCS-6-98, 117 (Nov. 24, 1998).
- 5 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.
- 6 Pub. L. No. 105-206, 112 Stat. 685, 771 (1998).

Senate report states that Section 3505 “requires the IRS to notify the taxpayer of the *specific reasons* for the disallowance (or partial disallowance) of the refund claim” (emphasis added).<sup>7</sup> The legislative history also shows Congress meant for the IRS to provide information “so that the taxpayer may appropriately respond to the IRS.”<sup>8</sup>

RRA 98 does not require the IRS to explain the claim disallowance on any specific letter or notice, in any specific format, or at any specific time.<sup>9</sup> However, the Internal Revenue Manual (IRM) reflects that the IRS uses notices of claim disallowance to meet the Section 3505 requirement.<sup>10</sup> When RRA 98 was enacted, the IRS issued multiple memos to employees, reinforcing the requirement to explain a claim disallowance.<sup>11</sup> The IRS revised two publications, including Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund*, to reflect that the IRS must send the taxpayer an explanation if it disallows a claim for refund.<sup>12</sup> It also updated IRM Part 21, *Customer Account Services*, to require an explanation. The IRM states, “Letters must contain the specific reason for the claim disallowance. An IRC section, if provided by Examination, should be cited.”<sup>13</sup>

### *Types of Refund Disallowance Notices*

The IRS uses different types of notices, some of which are required by statute, to tell taxpayers their claims are disallowed. If the IRS disallows any portion of a claim for refund or credit of an overpayment, IRC § 6532(a) requires it to mail to the taxpayer, by certified or registered mail, a notice of claim disallowance in order to commence the two-year statute of limitations on filing suit to challenge the disallowance in a United States District Court or the Court of Federal Claims.<sup>14</sup> Notices mailed pursuant to IRC § 6532(a), known as “statutory notices of claim disallowance,” can be stand-alone notices<sup>15</sup> or be combined with another notice.<sup>16</sup> In situations where a taxpayer’s claim for refund is pending during an examination and a statutory notice of deficiency has not been issued, the IRS will issue a combined

7 S. Rep. No. 105-174, at 97 (Apr. 22, 1998).

8 JCT, General Explanation of Tax Legislation Enacted in 1998, JCS-6-98, 117 (Nov. 24, 1998).

9 There are no regulations or official guidance from Counsel that specifies when and in what form the IRS has to provide the explanation required by IRC § 6402(l).

10 See IRM 4.71.8.6.3, *Processing a Claim When Taxpayer Contact Is Made* (July 29, 2014) (discussing the IRC § 6402(l) requirement in a section regarding Letter 569-A, *Claim Disallowance Notification Letter*). See also IRM 8.7.7.2.4, *Periods of Limitation in Claim and Overassessment Cases* (Oct. 16, 2014) (stating that per IRC § 6402(l), the statutory notice of claim disallowance must include an explanation of the reason for the disallowance); IRM 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures* (Dec. 20, 2010) (noting that disallowance letters must contain the specific reason for the disallowance).

11 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-13244, AT-2009-13244, AT-2009-13246 (retrieved May 28, 2014). The IRS uses LATIS to track all provisions, actions, and status of enacted legislation that impacts the IRS. The Action Plan lists Action Items and is used to record and track relevant contacts and activities as they occur, covering the time frame from passage of the legislation to full implementation.

12 IRS Legislative Analysis, Tracking and Implementation Services (LATIS) Explanation of Provisions, AT-2009-13241 (retrieved May 28, 2014). See IRS, Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund* 16 (Sept. 2013).

13 IRM 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures* (Dec. 20, 2010).

14 IRC § 6532(a)(1) provides, “No suit or proceeding under section 7422 (a) for the recovery of any internal revenue tax, penalty, or other sum, shall be begun before the expiration of 6 months from the date of filing the claim required under such section unless the Secretary renders a decision thereon within that time, nor after the expiration of 2 years from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of the part of the claim to which the suit or proceeding relates.”

15 See, e.g., Letter 105C.

16 See, e.g., Letter 3219.

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**In its report on the IRS Restructuring and Reform Act of 1998, the Joint Committee on Taxation stated: “Congress believed that taxpayers are entitled to an explanation of the reason for the disallowance or partial disallowance of a refund claim so that the taxpayer may appropriately respond to the IRS.”**

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statutory notice of claim disallowance and statutory notice of deficiency.<sup>17</sup>

Taxpayers receiving the combined statutory notice can contest the disallowance in a United States District Court, the Court of Federal Claims, or the United States Tax Court.<sup>18</sup> In this Most Serious Problem, we also look at notices disallowing claims for innocent spouse relief<sup>19</sup> under the category of statutory notices of claim disallowance, although these notices provide a different time period and venue for challenging the disallowance.<sup>20</sup>

There is a second category of claim disallowance notices that are not mailed by certified or registered mail, and do not start the running of the statute of limitations for filing a refund suit. These notices, hereinafter referred to as “non-statutory notices of claim disallowance,” formally communicate to the taxpayer that his or her claim is denied, but have no effect on the statute of limitations for filing a refund suit. The IRS sometimes sends these letters after a statutory notice of claim disallowance, such as when Appeals issues a non-statutory notice of claim disallowance after Exam has issued a statutory notice of claim disallowance. In other cases, the non-statutory notice is followed by the statutory notice of claim disallowance. In still other cases, when the taxpayer waives the right to the statutory notice of claim disallowance, the taxpayer will only receive the non-statutory notice. Under the regulations, if a taxpayer waives the right to receive the statutory notice of claim disallowance, the filing of the waiver will begin the running of the two-year statute of limitations to file suit.<sup>21</sup>

In addition to these two categories, we also discuss “No Consideration” letters. These letters are not technically claim disallowance notices because the IRS is not disallowing the claim; it is saying the claim cannot be processed because the IRS does not have enough information. If the taxpayer does not respond to the “No Consideration letter,” the IRS does not follow the letter with another communication nor does

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- 17 See IRM 4.8.9.15.2, *Disallowed Claims for Refund and Examination Results in Deficiency* (July 9, 2013). The IRM provides that the statutory notice of deficiency will include immediately after the summary of the tax liability, or as an attachment, a paragraph informing the taxpayer that the claim has been disallowed and he or she may file suit within two years of the date of mailing on the notice in a United States district court or the Court of Federal Claims. The IRM also instructs the employee to provide an explanation of any additional deductions or reductions in income that were requested in the claim and are disallowed.
- 18 See, e.g., *McCormack v. Commissioner*, No. 1773-13 (T.C. Oct. 24, 2014) (order discharging the prior order to show cause as to why the case should not be dismissed for lack of jurisdiction). Where the IRS issued a statutory notice of deficiency that also clearly stated that the taxpayer’s claim for refund was being disallowed, the court found “IRC § 6512 contemplates treating the disallowed claim for a refund as a claim under our overpayment jurisdiction, so there is no problem with our jurisdiction.”
- 19 IRC § 6013(d)(3) provides that married taxpayers who file a joint return under section 6013 will be jointly and severally liable for the income tax arising from that joint return. By requesting innocent spouse relief under IRC § 6015, in certain circumstances, one spouse may be relieved of the joint and several liability imposed by IRC § 6013(d)(3).
- 20 IRC § 6015(e)(1)(A) provides a taxpayer requesting innocent spouse relief may petition the Tax Court to determine the appropriate relief available. The petition must be filed no later than 90 days after the IRS mails, by certified or registered mail, the notice of the IRS’s final determination of relief available to the individual. IRC § 6015(e)(3) provides that if a refund suit is brought under IRC § 6532, the Tax Court shall lose jurisdiction of the individual’s action under IRC § 6015 to whatever extent jurisdiction is acquired by the district court or the Court of Federal Claims over the taxable years that are the subject of the suit for refund, and the court acquiring jurisdiction shall have jurisdiction over the petition filed under IRC § 6015(e).
- 21 Treas. Reg. § 301.6532-1(c). The waiver form must include: the type of tax and the taxable period covered by the taxpayer’s claim for refund, the amount of the claim, the amount of the claim disallowed, and a statement that the taxpayer agrees the filing of the waiver will commence the running of the two-year statute of limitations to file suit. The limitation restricting the taxpayer from filing suit until six months after the date the claim for refund was filed still applies even if the waiver is filed within this six month period. *Id.* The IRS typically uses Form 2297, *Waiver of Statutory Notice of Claim Disallowance*, for this purpose.

it issue a statutory notice of claim disallowance. “No Consideration” letters are different from refund hold notices,<sup>22</sup> because with a refund hold notice, the taxpayer eventually receives a statutory notice of claim disallowance in most circumstances.<sup>23</sup> Therefore, for purposes of this MSP, we have not analyzed refund hold notices.

### TAS’s Analysis of Certain Refund Disallowance Notices Finds They Do Not Satisfy the Intent of RRA 98.

To determine whether the IRS meets the requirement of providing an explanation of the reason for disallowance, TAS identified over 50 notices of claim disallowance the IRS uses to deny different types of claims. Some letters, such as 105C, *Claim Disallowed* and 106C, *Claim Partially Disallowed*, are used by multiple IRS functions to deny multiple types of claims; others are sent to deny specific types of claims.<sup>24</sup> To identify the most common letters and analyze the explanations received most frequently by taxpayers, TAS attempted to find the volume for each letter<sup>25</sup> and the frequency of different standard paragraphs used.<sup>26</sup> Although the IRS can track the volume for many of its notices and letters, it has no way of tracking what standard paragraphs are inserted into letters generated by the Correspondex system.<sup>27</sup> Furthermore, once notices are sent, employees face difficulty obtaining a copy of the actual letter sent to see the specific language.<sup>28</sup> This makes it challenging for employees to answer taxpayers’ questions arising from the notices.

For our analysis, we chose to look at what we identified as the main letters sent out in the context of examination, general claims for refund (often filed on an original or amended return), appeals, and innocent spouse claims. We included No Consideration letters, even though these are not technically notices of claim disallowance, because if taxpayers do not respond to these letters or submit new claims, their claims are effectively disallowed.

22 The notice the IRS sends to inform a taxpayer that his or her refund is being held or frozen is referred to as a refund hold notice for the purpose of this Most Serious Problem.

23 In some circumstances, such as in certain cases of identity theft, the IRS issues neither a refund hold notice nor a statutory notice of claim disallowance because it considers the returns to be nullities. See IRS Office of Chief Counsel Memorandum, *Identity Theft Returns and Disclosures Under Section 6103*, PMTA 2009-024 (June 8, 2008), available at [www.irs.gov/pub/lanao/pmta2009-024.pdf](http://www.irs.gov/pub/lanao/pmta2009-024.pdf).

24 Examples of specific letters are Letter 4878, *Notice of FICA Refund – Allowed/Disallowed Claims*, and Letter 5088C, *Requesting Spouse Final Determination Letter on Disallowed Innocent Spouse Claims* (Dec. 2012).

25 We were unable to find the volume for any of the Appeals letters because Appeals does not track this information. IRS Response to TAS Information Request (Oct. 10, 2014). The IRS does track volume for Correspondex letters, known as “C” letters”, which are computer generated. There are almost 800 “C-letters.” See IRS intranet, Correspondex Letters.

26 Each C letter gives the employee the ability to choose from a number of standard paragraphs to include in the letter. IRM 2.4.6.1, *Welcome to Correspondex* (Dec. 5, 2014).

27 Email from the IRS Office of Taxpayer Correspondence to TAS (Oct. 28, 2014) (on file with TAS).

28 The Office of Taxpayer Correspondence does not maintain copies of C-Letters once they are sent. Email from Office of Taxpayer Correspondence to TAS (Oct. 28, 2014) (on file with TAS). Statutory notices of claim disallowance, which are sent by certified or registered mail, are available on an internal database. See IRMs 21.5.3.4.6.2, *Appeals and Responses to Letter 105C and 106C* (May 30, 2014) and 21.5.3.4.6.1, *Disallowance and Partial Disallowance Procedures* (Dec. 20, 2010) (stating that once the letters are sent to the centralized print site, they will not be returned to be associated with the taxpayer’s file and will only be available on an internal database if needed at a later date). However, not all employees have access to the internal database, and locating an individual letter can be challenging. Furthermore, employees may not be able to help taxpayers when they call about a refund disallowance notice because there is a delay from when an employee requests a copy of the letter from the database to when he or she receives it.

FIGURE 1.17.1, Refund Disallowance Notices Analyzed by TAS<sup>29</sup>

Letter	Title	Revision Date	Description	Volume for FY 2014
Statutory Notices of Claim Disallowance				
Letter 105C	Claim Disallowed	Nov. 2012	Used by multiple functions for claim disallowance.	564,008
Letter 106C	Claim Partially Disallowed	Jan. 2014	Used by multiple functions to notify the taxpayer that their claim is partially disallowed.	40,339
Letter 1364	Appeals Full Disallowance of Claim - Certified Letter	Mar. 2009	Generated by Appeals and represents the taxpayer's legal notice of the full disallowance of the taxpayer's claim for refund.	Unavailable
Letter 1363	Appeals Partial Disallowance of Claim - Certified Letter	Apr. 2008	Generated by Appeals and represents the taxpayer's legal notice of the partial disallowance of the taxpayer's claim for refund.	Unavailable
Letter 5088C	Requesting Spouse Final Determination Letter on Disallowed Innocent Spouse Claims	Dec. 2012	Letter 5088C is used to notify the requesting spouse that the IRS is disallowing relief in full and to inform the taxpayer of his or her right to appeal the determination in the Tax Court.	3,152
Letter 5087C	Requesting Spouse Final Determination Letter on Partially Allowed Innocent Spouse Claims	Dec. 2012	Letter 5087C is used to notify the requesting spouse that the IRS is granting partial relief and to inform the taxpayer of his or her right to appeal the determination in the Tax Court.	2,402
Non-statutory Notices of Claim Disallowance				
Letter 569	Letter of Claim Disallowance	Aug. 2009	Used by Examination to advise the taxpayer when a claim is disallowed/allowed or partially allowed with reason for disallowance.	8,197
Letter 2681	Appeals Full Disallowance After Previous Claim Disallowance	Nov. 2006	Generated by Appeals to notify the taxpayer of the full disallowance of a claim where the IRS previously mailed a statutory notice of claim disallowance or the taxpayer waived his or her right to receive the statutory notification.	Unavailable
Letter 2683	Appeals Partial Disallowance After Previous Claim Disallowance	Nov. 2006	Generated by Appeals to notify the taxpayer of the partial disallowance of a claim where the IRS previously mailed a statutory notice of claim disallowance letter or the taxpayer waived his or her right to receive the statutory notice.	Unavailable
No Consideration Letters				
Letter 916C	Claim Incomplete for Processing; No Consideration	Mar. 2014	Used to notify the taxpayer that the IRS is unable to process his or her claim for refund.	28,196
Letter 3657C	No Consideration Innocent Spouse Claim Letter	Dec. 2012	Letter 3657C is used to notify the requesting spouse that he/she does not meet basic eligibility requirements and their claim will be closed as specified in this letter.	8,800

29 IRS Compliance Data Warehouse (data retrieved Nov. 10, 2014). The IRS Office of Appeals does not track letter volume data for Letters 1363, 1364, 2681, or 2683. IRS Response to TAS Information Request (Oct. 10, 2014).

## Analysis of Statutory Notices of Claim Disallowance

### *The IRS Fails to Ensure Statutory Claim Disallowance Letters 105C and 106C Provide Sufficient Explanations of Disallowances.*

Letters 105C and 106C are statutory notices of claim disallowance<sup>30</sup> that multiple IRS functions use to fully or partially deny claims for refund.<sup>31</sup> Employees generate these letters by inserting standard paragraphs that they customize slightly by entering specific information into fields, such as a dependent's name. However, there seems to be little oversight or accountability for what the letters actually say. From a sample of 18 Letters 105C and ten Letters 106C, TAS found two letters did not list any reason at all under the heading "WHY WE CANNOT ALLOW YOUR CLAIM" or "WHY WE PARTIALLY DISALLOWED YOUR CLAIM," a clear violation of Section 3505. The letters varied in terms of content; some letters included the amount of the claim and some did not. Two of the ten 106C letters stated the claim was only partially allowed, but the amount allowed was the same as the amount of the claim, meaning either that one of these amounts was incorrect, or the claim was not partially disallowed and the IRS sent the wrong notice.

One 105C letter listed the amount of the claim as ".00." Although it stated the refund was disallowed due to the expiration of the refund statute of limitations, the letter advised the taxpayer "You can submit for our consideration a statement telling us why you're not eligible for Medicare health coverage, Part A or B." If the taxpayer called the IRS to discuss this letter, the customer service representative on the phone would not be able to view the letter to clarify the reason for the disallowance.<sup>32</sup> However, if the employee were able to easily locate a copy of the letter, the IRS could verify the mistake and issue another notice of claim disallowance, although this notice would not provide a new time period to appeal the disallowance administratively or in federal court.<sup>33</sup>

TAS pulled a sample of 100 Letters 105C and determined that 92 of them did not provide adequate explanations that would satisfy the purpose of Section 3505.<sup>34</sup> Specifically, 30 letters included language that was not clear and written in plain language,<sup>35</sup> 58 did not sufficiently explain the specific reasons for the disallowance, and 65 did not provide the taxpayer with the information needed to respond to the IRS. TAS pulled a smaller sample of ten 106C letters that use similar standard paragraphs. One letter 106C included this confusing explanation:

We partially disallowed your claim because We [sic] have allowed only the Earned Income Tax Credit for [name redacted]. As you did not provide proof of support, we did not allow

30 These notices are mailed by certified or registered mail and therefore start the running of the two year statute of limitations for filing a refund suit. See IRC § 6532(a)

31 Submission Processing generally uses Letter 105C to initially deny a claim for refund if the refund is the only issue, and Letter 106C to initially deny a claim for refund when there are other issues. See IRM 3.11.6.9.3, *Correspondence for Disallowing a Claim (105C and 106C Letters)* (July 24, 2014). Examination also uses Letters 105C and 106C. See IRM 4.19.16.1.4.2, *Claims Contact Responses* (Nov. 4, 2011).

32 See footnote 28, *supra*.

33 If the IRS were to issue another notice of claim disallowance with the correct information, that subsequent notice would not operate to extend the period for filing a refund suit. See IRC § 6532(a)(4). Letter 105C notifies taxpayers of their right to appeal the disallowance administratively, and states "If we do not hear from you within 30 days from the date of this letter, we will process your case without further action."

34 Letters were deemed to satisfy the purpose of Section 3505 if reviewers answered "Yes" for the following three questions: Does the letter provide the specific reason the refund claim was disallowed? Was the description of the reason for the disallowance written in clear and plain language that an average taxpayer would understand? If you were the taxpayer and you disagreed with the disallowance, based on the information on this notice would you understand what you need to do in order to dispute the disallowance?

35 See Plain Writing Act of 2010, Pub. L. No. 111-274, 124 Stat. 2861 (2010).

the dependent exemptions, Child Tax credit, Additional Child Tax Credit or the Head of Household Filing Status.

This explanation is incomplete, confusing, and could lead to an interpretation that is an incorrect statement of the law. The use of the word “or” when listing the different exemptions, credits, and filing status is confusing because the taxpayer does not know if the IRS is denying all four items, some of them, or just one. The first sentence makes it appear as though the IRS is allowing the Earned Income Tax Credit (EITC) for one child, but not others. However, the second sentence makes it seem that the taxpayer cannot include any children for dependent exemptions for the purpose of Head of Household Filing Status, which would likely mean no children would be eligible for the EITC.<sup>36</sup> In addition, if the second sentence is interpreted to require the taxpayer to prove that he or she provided support to the child claimed, it gives an inaccurate statement of the law. Under IRC § 152(c), a qualifying child can be claimed as an exemption and qualify an individual for Head of Household filing status under IRC § 2(b)(1) if, among other requirements, the child did not provide over one-half of his or her own support for the calendar year in which the taxable year of the taxpayer begins. There is no requirement that the taxpayer must have provided support to the child.<sup>37</sup> Furthermore, even if the taxpayer can identify which items are disallowed, to which children the letter refers, and who must prove support, the letter does nothing to explain how the taxpayer can prove someone other than the child provided over half of his or her support. The sheer complexity of the underlying law cries out for clearer explanations so the taxpayer can understand the error and respond appropriately, if at all.

Some 105C letters offered even less information. A similar letter provided more specific details by naming which child was disallowed, but nonetheless failed to state what was disallowed, *e.g.*, EITC, child tax credit, etc.<sup>38</sup> Another letter simply stated, “You were claimed as a dependent on another taxpayer’s return,” without stating the consequences of this situation. Given the high improper payment rate for EITC claims,<sup>39</sup> providing clear and easily understandable explanations of why a taxpayer did not qualify is especially important to educate taxpayers and prevent future erroneous EITC claims.

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- 36 IRC § 32(c)(3) defines “qualifying child” for the EITC by referring to the definition of “qualifying child” in IRC § 152(c), which defines it for the purpose of claiming a child as a dependent, except that the requirement that the child must provide no more than one-half of his/her own support for the calendar year in which the taxable year of the taxpayer begins is not applicable, and the special rules for divorced parents under IRC § 152(e) do not apply. IRC § 32(c)(3)(C) further requires the qualifying child for the EITC to have his or her principal place of abode in the United States and IRC § 32(m) requires the child to have a Social Security number. Thus, children who are qualifying children under IRC § 32 for the purpose of the EITC can also be claimed as dependents under IRC § 152 for the purpose of Head of Household filing status so long as they also meet the support test under IRC § 152(c)(1)(D) and the rules regarding divorced parents under IRC § 152(e).
- 37 However, if the child did not meet the other requirements to be considered a qualifying child and the taxpayer were to claim an exemption for the child as a qualifying relative, the taxpayer would need to have provided over one-half of the child’s support for the calendar year in which the taxable year began. See IRC § 152(d)(1)(C). Also, if the taxpayer was married during the year and lived apart from his or her spouse, in order to claim head of household filing status he or she must meet the requirements under IRC § 7703(b). This section requires the taxpayer to: file a separate return; maintain as his or her home a household which constitutes for more than one-half of the taxable year the principal place of abode of the child who can be claimed as a dependent; and furnish over one-half of the cost of maintaining such household during the taxable year. In addition, under IRC § 7703(b), the taxpayer’s spouse cannot be a member of the household during the last six months of the taxable year.
- 38 This letter only stated: “We disallowed [name redacted] because you did not verify she was related and lived with you more than 6 months. The school records only verified an approximate 3 months.”
- 39 The improper payment rate for FY 2012 attributable to EITC is 22.8 percent (or \$12.6 billion). Fiscal Year 2013 Agency Financial Report – Department of the Treasury 210 (Dec. 13, 2013). The \$12.6 billion amount is the midpoint between Treasury’s lower and upper estimate. This is based on estimates of dollars ultimately incorrectly issued (taxpayer overclaims are net of amounts the IRS prevents or recovers). IRS, RAS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 6 (Feb. 12, 2014) (unpublished).

TAS pulled a sample of 100 Letters 105C (Statutory Notice of Claim Disallowance) and determined that 92 of them did not provide adequate explanations that would satisfy the purpose of Section 3505. Specifically, 30 letters included language that was not clear and written in plain language, 58 did not sufficiently explain the specific reasons for the disallowance, and 65 did not provide the taxpayer with the information needed to respond to the IRS.

Letters denying the EITC due to problems with wages reported on Form W-2, which made up about half of the 100 105C letters in our sample,<sup>40</sup> stated exactly *why* the refund was disallowed, but were not specific enough for the taxpayer to know *what* was incorrect. These notices stated “We have information that the Form(s) W-2, Wage and Tax Statement, attached to your return for the tax period shown above misrepresented your correct income and/or federal tax withheld and have been removed. The following credit(s) have been eliminated based on the removal of the wages (earned income): The Earned Income Tax Credit.” Missing from these letters was key information such as which Form W-2 was incorrect (an issue for taxpayers with multiple employers), whether it was the wages or withholding that was incorrect, and why the IRS determined these numbers were not correct. A taxpayer would not know how to respond or what steps to take without calling the IRS to find out which numbers were wrong.<sup>41</sup> The failure to provide specific reasons causes more work for not only the taxpayer, but also the IRS.

The second most common type of notice from our sample of 100 105C letters, those that denied the claim due to the expiration of the refund statute of limitations,<sup>42</sup> also did not provide enough information. Only two of the 31 notices in this group included helpful information such as the following: “The postmark date on your tax return’s envelope is May 23, 2014. The expiration date for filing a claim for tax year 2008 was Apr. 15, 2012. We couldn’t allow your claim because it was not postmarked on or before the deadline.” The

other 29 notices included a date of the claim at the top of the letter and a complicated description of the refund statute rules, but never said in plain language exactly what day the claim was due and what day the IRS deemed the return to be filed. Without this information, a taxpayer whose return had been filed on time may not know he or she can challenge the disallowance. In fact, in certain instances, the IRS incorrectly calculates the date the claim is received. TAS pulled a sample of 50 of its cases from fiscal year 2014 where the primary or secondary issue was the refund statute expiration date. In over half of these cases, the taxpayer was entitled to a refund, but a manual review was required to verify the IRS received date. In these instances, the IRS’s failure to provide an explanation impairs the taxpayer’s *right to challenge the IRS and be heard*.

### *Statutory Innocent Spouse Letters Provide Good Examples of Explanations.*

The two final determination letters issued by the Innocent Spouse unit to deny a claim for refund are Letter 5087C, *Requesting Spouse Final Determination Letter on Partially Allowed Innocent Spouse Claims*, and Letter 5088C, *Requesting Spouse Final Determination Letter on Disallowed Innocent Spouse Claims*.<sup>43</sup>

40 Forty-seven out of the 100 105C letters disallowed an EITC refund because income on Form W-2 appears to have been misreported.

41 Calling the IRS to find the reason may be problematic. For the first four months of FY 2014, the level of service on the phones was 62.5 percent, meaning over a third of calls to the IRS were not answered. See National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 157.

42 These notices made up 31 of the sample of 100 105C letters. IRC § 6511(a) provides the general statute of limitations on filing a refund claim—the later of three years from the date the return was filed, or two years from the date the tax was paid.

43 The Innocent Spouse unit also uses preliminary determination letters. We did not analyze these letters because, in some cases, the determination may change after the preliminary letter if the taxpayer submits additional documentation.

These letters provide excellent examples of thorough explanations for disallowing a taxpayer's claim for refund and should serve as a model for other IRS letters.<sup>44</sup>

Letter 5087C states, "We reviewed your claim stating the joint return for tax year(s) [blank] is/are invalid. It appears you intended to file a joint return. We determined it is valid for the reason(s) listed below."<sup>45</sup> While many IRS letters would stop here, at the general explanation of what disqualifies a person for innocent spouse relief, this letter goes on to give a specific reason why the joint return was valid. For example, the letter might state the taxpayer signed the refund check or had a history of filing joint returns. This letter includes detailed paragraphs about how to file a petition in the Tax Court to challenge the determination, including the address to send the petition and the Tax Court's website. A taxpayer who receives this letter is empowered with the information needed to understand why he or she is not receiving a refund and what to do if he or she does not agree.

### Analysis of Non-statutory Notices of Disallowances

#### *Use of Letter 569 (SC) with the Request to Waive the Statutory Notice of Claim Disallowance Infringes Taxpayer Rights and Does Not Provide All Taxpayers with a Sufficient Explanation for the Disallowance.*

The Examination function uses Letter 569 (SC), a non-statutory notice of claim disallowance, to initially notify the taxpayer of the partial or full disallowance of a claim for refund.<sup>46</sup> Exam sends this letter with a form asking the taxpayer to waive the right to a statutory notice of claim disallowance.<sup>47</sup> If the taxpayer agrees, then this may be the only refund disallowance notice he or she will receive, unless the taxpayer receives the combination statutory notice of deficiency and notice of claim disallowance on a single letter ("combination letter"), a letter that easily gives rise to confusion.<sup>48</sup> If the taxpayer does not agree, the taxpayer will receive a statutory notice of claim disallowance in the form of Letter 105C or Letter 106C.<sup>49</sup>

Allowing the taxpayer to waive the right to receive the statutory notice of claim disallowance can save the IRS resources by not requiring an additional notice be sent by certified or registered mail. However, the current use of Letter 569 (SC) to request the waiver infringes upon a taxpayer's *right to be informed* and *right to appeal an IRS decision in an independent forum*. The letter does not explain the significance of waiving the statutory notice, nor does it even imply the taxpayer has a choice if he or she agrees with the adjustment. The letter states, "If you agree with our findings, please sign, date, and return: [check box] Form 2297, Waiver of Statutory Notification of Claim Disallowance."<sup>50</sup> Letter 569 (SC) does not explain that the taxpayer can choose not to sign this form and receive the statutory notice. Nor does it explain that the two-year period to file suit in a United States District Court or the Court of Federal Claims

44 Not all Innocent Spouse determination letters are refund disallowance letters because in some cases, the taxpayer or taxpayers may not have paid the tax before submitting the request for innocent spouse relief and thus are not claiming a refund.

45 As the basis for a request for innocent spouse relief, a taxpayer may argue that the joint return is not valid and therefore the taxpayer should not be held jointly or severally liable for the liability.

46 See IRM 4.19.16.1.4.1, *Claims Contact Procedures* (Nov. 4, 2011).

47 See Form 2297, *Waiver of Statutory Notice of Claim Disallowance* (Mar. 1982).

48 See, e.g., *McCormack v. Commissioner*, No. 1773-13 (T.C. Oct. 24, 2014) (order discharging the prior order to show cause as to why the case should not be dismissed for lack of jurisdiction) (professing that the notice of deficiency stating that it was a disallowance of refund "puzzled the Court because it had never before seen such a notice, and thinking this might not be a deficiency case at all it issued an order to the parties to show cause why the case shouldn't be dismissed for lack of jurisdiction.").

49 IRM 4.19.16.1.4.2, *Claims Contact Responses* (Nov. 4, 2011). Letters 105C and 106C are used by all functions (except TAS, which has no authority to disallow a claim for credit or refund) to notify a taxpayer that his or her claim is fully or partially disallowed.

50 Letter 569 (SC) (Aug. 2009).

otherwise would not begin until the IRS sends the taxpayer the statutory notice. While Form 2297 itself states, “I understand that the filing of this waiver is irrevocable and it will begin the 2-year period for filing suit for refund of the claims disallowed as if the notice of disallowance had been sent by certified or registered mail,” it does not identify the court where the taxpayer may file suit. It also fails to explain that this is the taxpayer’s *only* opportunity to challenge the disallowance in court.

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**One notice states, “We are unable to process your claim for the tax period(s) shown above because your supporting information was not complete. If you have more information you did not send with this claim, you may file another claim and attach your information.” This clearly does not provide specific reasons for the claim disallowance or explain what supporting information was incomplete or lacking, nor does it tell the taxpayer how to fix the issue or respond.**

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Of 7,962 taxpayers who received Letter 569 during fiscal year (FY) 2014, only a little over half (4,294) subsequently received Letter 105C or 106C.<sup>51</sup> Although some of these taxpayers who did not receive Letter 105C or 106C may have eventually had their claims allowed or received a lesser used statutory notice of claim disallowance, this figure suggests a large number of taxpayers may have had to rely only on Letter 569 or to explain the disallowance.<sup>52</sup>

Letter 569 (SC) does not provide an explanation of the refund disallowance on the actual letter, and instead refers the taxpayer to the attached Form 886-A, *Explanation of Items*. Forms 886-A vary greatly in terms of their explanations. Some provide thorough explanations with sufficient details for the taxpayer to know exactly what was disallowed, what documentation would have been required to prove the item claimed, and why the taxpayer’s documentation fell short. However, TAS pulled a sample of ten Forms 886-A and found two included completely unacceptable explanations for the refund disallowance such as “Since you did not establish that you are entitled to the exemption(s), it/they is/are being disallowed.” The IRS could disallow the exemptions for numerous reasons, such as the person claimed did not bear the correct relationship to the taxpayer or the person claimed had income that was too high.<sup>53</sup> Without providing the specific reasons for the disallowance, Form 886-A attached to Letter 569 (SC) does not comply with Section 3505 of RRA 98.

### *Some Letters Used by Appeals Do Not Contain Explanations of Why the Claim Was Disallowed.*

The Office of Appeals uses two sets of letters to disallow refunds, depending on whether the taxpayer has already received a statutory notice of claim disallowance or waived his or her right to receive one. When the taxpayer has previously received a statutory notice of claim disallowance or waived the right to one, Appeals uses Letters 2681 and 2683—neither of which explains the disallowance.

Letter 2681 states: “Based on the information submitted, there is no basis to allow any part of your claim.” Although one could argue that this letter does not need to include the reason for the disallowance

51 IRS Compliance Data Warehouse (data retrieved Nov. 10, 2014). Of the 46 percent who did not subsequently receive Letter 105C or 106C, it is unknown how many waived their right to receive the statutory notice of claim disallowance, how many received a combination letter or other statutory notice of claim disallowance, or how many had claims which were allowed before the Letter 105C or 106C could be issued.

52 Although 7,962 different taxpayers received Letter 569 during FY 2014, as indicated in the preceding table, 8,197 Letters 569 were actually issued as some taxpayers receive more than one letter.

53 See IRC §§ 151 and 152 for the specific requirements for claiming personal exemptions and who may be claimed as a dependent.

because the taxpayer has already received a notice from Examination,<sup>54</sup> Appeals may have based the disallowance on different reasons than Examination. Appeals may have looked at other factors such as case law, credibility of witnesses, and hazards of litigation. The *right to be informed* and the *right to challenge the IRS's position and be heard* mean the taxpayer needs to know why the IRS took the action it did; otherwise, the IRS action could be arbitrary and capricious. Moreover, taxpayers have the *right to appeal an IRS decision in an independent forum*. If a taxpayer receives no explanation as to why that independent forum (the IRS Office of Appeals) made a decision, the taxpayer will have no faith that he or she received “a fair and impartial administrative appeal.”<sup>55</sup>

Letter 2683, used for a partial disallowance, states:

Based on the information you submitted, I am pleased to tell you that we are allowing [blank] of your claim. However, the rest of the claim is not allowed. After your claim has been processed, the [blank] will send you a notice explaining any changes that we have made to your tax account.

Although Section 3505 of RRA 98 does not require the IRS to provide an explanation on every notice, it is appropriate for the IRS to provide the explanation at the time when a determination is made to disallow or partially disallow a refund, even if the determination is sustaining a prior determination. The taxpayer needs to be able to respond to *this* notice, which means it should explain why the refund was not allowed.

### No Consideration Letters

#### *Many “No Consideration” Letters Lack Explanations, Except for Those Related to Innocent Spouse Claims.*

In addition to the letters that formally notify the taxpayer that it disallowed his or her claim for refund, the IRS uses letters that notify the taxpayer that it cannot even consider the claim. These “No Consideration” letters do not specifically state a refund is being disallowed, but say something like “We are unable to process your claim,”<sup>56</sup> or “You didn’t meet the basic eligibility requirements because ...”<sup>57</sup>

Although these letters do not state that the refund is disallowed and do not start the running of the statute of limitations to file suit, the refund is effectively disallowed unless the taxpayer provides additional documentation or submits a new claim. A paragraph on Letter 916C states, “We are unable to process your claim for the tax period(s) shown above because your supporting information was not complete. If you have more information you did not send with this claim, you may file another claim and attach your information.” This clearly does not provide specific reasons for the claim disallowance or explain what supporting information was incomplete or lacking, nor does it tell the taxpayer how to fix the issue or respond.

54 In its response to TAS’s information request, the Office of Appeals stated “Letters 2681 and 2683 are issued by Appeals after the IRS issued the statutory notice of claim disallowance letter, so the requirements of IRC 6402(l) do not apply to these two letters.” IRS Response to TAS Information Request (Oct. 10, 2014).

55 See IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014) (“Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals’ decision. Taxpayers generally have the right to take their cases to court.”).

56 Letter 916C, *Claim Incomplete for Processing; No Consideration* (Mar. 2014).

57 Letter 3657C, *No Consideration Innocent Spouse Claim* (Dec. 2012).

Conversely, Letter 3657C, the “No Consideration” letter for innocent spouse claims, includes helpful explanations. For example, for a taxpayer who submitted an innocent spouse claim<sup>58</sup> when he or she should have submitted an injured spouse claim,<sup>59</sup> the letter states:

Our records show you may qualify for injured spouse relief instead of innocent spouse relief. When a joint return is filed and the refund is used to pay one spouse’s past-due child support, spousal support (or other federal non-tax debt), student loans, federal or state taxes, the other spouse may be considered an injured spouse.

The letter goes on to explain how to file a claim for Injured Spouse relief, including the name of the form, and a phone number to use if the taxpayer has any questions. This letter not only explains why the Innocent Spouse claim is disallowed, but gives the taxpayer the information to respond. It is unclear why the IRS cannot use the Innocent Spouse letters as a model for providing clear, specific, and complete explanations to taxpayers.

## CONCLUSION

RRA 98 requires IRS notices to go beyond just stating that a refund is disallowed. Notices must provide the taxpayer with specific reasons for the disallowance and give the taxpayer the information he or she needs to respond. Many of the notices the IRS uses are deficient in both regards. These notices violate a taxpayer’s *right to be informed* because the taxpayer cannot find out why a claim is denied. These notices also violate a taxpayer’s *right to challenge the IRS’s position and be heard* because the taxpayer needs certain information to challenge the IRS—specifically what on the return or claim was disallowed and what documents the taxpayer can submit to challenge the disallowance or cure the claim. Finally, some of the notices impair a taxpayer’s *right to appeal an IRS decision in an independent forum* by soliciting a waiver of the statutory notice of claim disallowance without explaining where to file suit or the consequences for failing to timely file suit. For these reasons, the IRS must follow the directive of Congress and revise its refund disallowance letters as well as the process for generating them.

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<sup>58</sup> See Form 8857, *Request for Innocent Spouse Relief*.

<sup>59</sup> See Form 8379, *Injured Spouse Allocation*. Form 8379 is filed by one spouse (the injured spouse) on a jointly filed tax return when the joint overpayment was (or is expected to be) applied (offset) to a past-due obligation of the other spouse. By filing Form 8379, the injured spouse may be able to get back his or her share of the joint refund.

## RECOMMENDATIONS

To honor a taxpayer's right to receive an explanation for the disallowance of a refund claim, the National Taxpayer Advocate recommends that the IRS:

1. Issue a stand-alone statutory notice of claim disallowance in all cases where the taxpayer does not waive the right to receive one.
2. Maintain copies of all refund disallowance notices on an electronic database that employees can easily access when working inquiries related to the letters.
3. Revise Letter 569 (SC) to clearly explain a taxpayer's right to challenge the claim disallowance in court and the consequences of waiving the right to receive the statutory notice of claim disallowance.
4. Revise Form 2297 to include further information about the taxpayer's right to appeal, including the court where the taxpayer may file suit, and a statement that this is the taxpayer's only opportunity to challenge the disallowance in court.
5. Require all letters or notices stating that a claim for refund is being partially or fully disallowed, regardless of whether they start the running of the statute of limitations on filing suit, to explain the specific reasons for the disallowance. This explanation can be included on an attachment, such as Form 886-A attached to Letter 569 (SC).
6. Provide training to all employees who create notices of claim disallowance and "No Consideration" letters to reinforce the requirement to provide an explanation of the specific reasons for the disallowance, with detailed guidance on explaining the most common reasons for disallowance, such as the expiration of the refund statute.
7. Require all notices of claim disallowance and "No Consideration" letters to include the amount of the claim.
8. Require all notices of claim disallowance where the reason for disallowance is the expiration of the refund statute of limitations to include the date the return was deemed filed, how the IRS calculated that date, and the date the claim was due.
9. Require "No Consideration" letters to include an explanation of the specific reason for the disallowance, and if supporting documentation was not accepted, an explanation of why and what the taxpayer can do to cure the claim.
10. For notices of disallowance where the taxpayer can challenge the refund disallowance in court, provide details similar to those in Letter 5087C, including where to find more information about filing refund suits.

**MSP  
#18****COLLECTION DUE PROCESS: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections****RESPONSIBLE OFFICIALS**

Kirsten B. Wielobob, Chief, Appeals  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division  
 Debra Holland, Commissioner, Wage and Investment Division

**DEFINITION OF PROBLEM**

The recently adopted Taxpayer Bill of Rights (TBOR) provides, among other rights, that taxpayers have *the right to appeal an IRS decision in an independent forum, the right to challenge the IRS's position and be heard, the right to privacy, and the right to a fair and just system.*<sup>1</sup> In the collection arena, these rights become concrete, meaningful, and significant through Collection Due Process (CDP).<sup>2</sup>

Prior to the IRS Restructuring and Reform Act of 1998 (RRA 98), taxpayers did not have the right to post-assessment and pre-collection review.<sup>3</sup> CDP procedures are designed to “increase fairness to taxpayers.”<sup>4</sup> The constitutional principle of due process “serves the greater purpose of engaging taxpayers and making them feel heard in a meaningful way, regardless of the outcome, it helps ease the sense among many taxpayers that the government acts in arbitrary ways.”<sup>5</sup> The procedural fairness that forms the basis of due process serves as the foundation for CDP. Congress believed “the IRS should afford taxpayers adequate notice of collection activity and a meaningful hearing before the IRS deprives them of their property,” and intended CDP to provide these protections.<sup>6</sup>

An integral component of the CDP analysis is the balancing test, which requires the IRS Appeals Officer (AO) to weigh the issues raised by the taxpayer and determine whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any

1 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

2 IRC §§ 6320; 6330.

3 Collection Due Process hearings were created by RRA 98. See RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998). See also IRC §§ 6320; 6330. Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. See *United States v. National Bank of Commerce*, 472 U.S. 713, 719-722 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

4 S. Rep. 105-174, at 67 (1998).

5 Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *The Tax Lawyer*, 63 *Tax Law* 227, 234 (2010).

6 S. REP. No. 105-174, at 67 (1998). See also J. Comm. on Tax'n, General Explanation of Tax Legislation Enacted in 1998, JCS-6-98 (Nov. 24, 1998).

collection be “no more intrusive than necessary.”<sup>7</sup> The balancing test is central to a CDP hearing because it instills a genuine notion of fairness into the process from the perspective of the taxpayer.<sup>8</sup> The balancing test also validates the taxpayer’s right to privacy by taking into account the invasiveness of enforcement actions and the due process rights of the taxpayer.<sup>9</sup>

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**The balancing test is central to a Collection Due Process hearing because it instills a genuine notion of fairness into the process from the perspective of the taxpayer.**

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A TAS review of applicable CDP procedures and case law reveals that the Office of Appeals is not giving proper attention to the balancing test, especially to legitimate concerns of taxpayers regarding the intrusiveness of the proposed collection action, and is often using *pro forma* statements that the balancing test has been conducted. These issues contribute to the appearance that Appeals is simply “rubber stamping” prior determinations made by Collection.<sup>10</sup>

The lack of detailed and specific procedures describing how to conduct the balancing test, along with inadequate training of Appeals and Collection employees on how to apply such a test, undermines the Appeals mission of fair and impartial decision-making based on congressionally mandated principles and could violate core taxpayer rights. The effective implementation of the balancing test is imperative to realizing taxpayer rights and improving voluntary compliance.<sup>11</sup>

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- 7 IRC § 6330(c)(3)(C); IRM 8.22.4.2.2 (Sept. 25, 2014). See also H.R. REP. No. 105-599, at 263 (1998) (Conf. Rep.). For simplicity, we use the term “proposed collection action” referring to both the actions taken and proposed. IRC § 6330 requires the IRS to notify the taxpayer of the right to request a CDP hearing not less than 30 days before issuing the first levy to collect a tax. Pursuant to IRC § 6320 the taxpayer is notified of the right to request a CDP hearing within five business days after the first Notice of Federal Tax Lien (NFTL) for a tax period is filed. Thus, Treasury Regulations under IRC § 6320 require a Hearing Office to consider “whether the continued existence of the filed Notice of Federal Tax Lien (NFTL) represents a balance between the need for the efficient collection of taxes and the legitimate concern of the taxpayer that any collection action be no more intrusive than necessary.” See Treas. Reg. § 301.6320-1(e)(3), A-E1(vi). Similarly, a levy action can be taken before a hearing in following situations: collection of the tax was in jeopardy; levy on a state to collect a federal tax liability from a state tax refund; disqualified employment tax levies, or a federal contractor levy under the Federal Payment Levy Program (FPLP). See IRC 6330(f); IRM 8.22.4.2.2 (Sept. 25, 2014).
- 8 “This final balancing factor is novel in American tax law and injects into the calculus an equitable consideration for the taxpayer and his concerns.” *Living Care Alternatives of Utica v. United States*, 411 F.3d 621, 625 (6th Cir. 2005). See also Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *The Tax Lawyer*, 63 TAX LAW. 227 (2010); TAS, TASCast, Roadmap to Tax Controversy, Level One – Part Three, available at <http://tasnew.web.irs.gov/video/Production/TASCasts/RoadmapToTaxControversy/LevelOnePartThree.html>.
- 9 The Right to Privacy provides: Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be *no more intrusive than necessary, and will respect all due process rights*, including search and seizure protections and will provide, where applicable, a collection due process hearing. (emphasis added). IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights#privacy>.
- 10 “In most cases, reviewing courts have merely affirmed the Appeals Officer’s determination that [the Appeals Officer] conducted the balancing test and that he found the results to be consistent with the decision to proceed with levying the property.” *Living Care Alternatives of Utica v. United States*, 411 F.3d 621, 627 (6th Cir. 2005).
- 11 TAS research has shown that factors related to trust in government and fairness appear to have significant influence on the taxpayer compliance behavior of self-employed taxpayers. National Taxpayer Advocate 2013 Annual Report to Congress, Vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*).

## ANALYSIS OF PROBLEM

### Background and the early seeds of the Taxpayer Bill of Rights (TBOR)

Testimony delivered in the Senate Finance Committee hearings preceding RRA 98 laid the foundation for CDP hearings. One commentator, Michael Saltzman, a tax attorney with over 33 years of experience and the author of a seminal treatise on tax practice and procedure,<sup>12</sup> made the following recommendations for enhanced due process protection in tax collection in response to questions from Senator Roth:

As your hearings have confirmed, revenue officers in IRS district Collection Divisions have enormous discretion in taking collection action against taxpayers, including the filing of notices of federal tax liens against their property, serving levies, and seizing and selling their property. Taxpayers are deprived of their property without due process because there is no statutory procedure for any independent review of the revenue officer's collection decision ...

Accordingly, I recommend adoption of the following procedures:

- a. There should be a statutory procedure for the review of IRS collection action.
- b. The model for this review procedure should be Section 7429, which permits a taxpayer to obtain administrative and judicial review of a jeopardy assessment or jeopardy levy ...
- c. I believe that threatened liens and levies should be reviewed by an Appeals officer. Unlike the jeopardy levy review procedures, I recommend that judicial review be conducted by special trial judges of the Tax Court, who will hear the case on an expedited basis.<sup>13</sup>

Congressional testimony further explained, “Many people were shocked to learn that a number of the due process protections Americans take for granted in other legal proceedings do not apply to actions involving the IRS.”<sup>14</sup> This notion of procedural fairness, originating from the constitutional principles of due process, laid the theoretical foundation for CDP. The CDP balancing test requirement is critical to due process and fairness of tax administration—it does not dictate the outcome, but it does weigh the impact of the proposed collection action on the taxpayer with the government's interest for efficient collection of taxes. The balancing test recognizes the Supreme Court's maxim in *Bull v. United States* that “taxes are the lifeblood of the government,”<sup>15</sup> but also acknowledges that it is the taxpayers who provide that lifeblood.<sup>16</sup>

Likewise, judicial review of CDP hearings strives to maintain transparency and accountability of the IRS to the taxpayer.<sup>17</sup> For these reasons, Congress created CDP to provide extra measures of protection for

12 See Michael I. Saltzman, Leslie Book, *IRS Practice and Procedure*, Thomson Reuters Tax and Accounting (Rev. 2nd ed. 2009-2013).

13 *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong. 376 (1998) (Testifying Attorney Michael Saltzman's responses to questions from Senator Roth).

14 144 Cong. Rec. 4, 190 (1998) (statement made on the Senate Floor by Senator Enzi of Wyoming).

15 295 U.S. 247, 259 (1935).

16 Nina E. Olson, *Taking the Bull by Its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, *The Tax Lawyer*, 63 TAX LAW. 234 (2010).

17 *Id.* at 235.

taxpayers against abuse in the collection arena and included the balancing test among the three major elements of a CDP hearing to ensure that any collection be “no more intrusive than necessary.”<sup>18</sup>

These principles were incorporated into the TBOR adopted by the IRS. The IRS has acknowledged the taxpayer’s *right to privacy*, which provides that any IRS enforcement action will comply with the law and be *no more intrusive than necessary*, and that the IRS will respect all due process rights of taxpayers.

### Hearing officers are provided little guidance or training on how to perform the balancing test.

Hearing Officers<sup>19</sup> are required by law to consider three areas in a CDP determination:<sup>20</sup>

1. Verify that the requirements of any applicable law or administrative procedures are met;
2. Consider any relevant issues raised; and
3. Conduct the balancing test.<sup>21</sup>

The Internal Revenue Manual (IRM) describing the balancing test recommends that employees consider the following three factors:

- a. The taxpayer’s actions or inaction;
- b. The taxpayer’s compliance history; and
- c. The taxpayer’s financial circumstance.<sup>22</sup>

There is nothing in the IRM that elaborates on the balancing test or advises employees how to analyze the factors. There is no mention of purpose of the balancing test or the role it plays in ensuring due process and fairness in tax administration. In total, employees are provided five points of instruction coupled with four examples. Three of the four examples contain the following sentence: “It is my judgment that the [Notice of Intent to Levy or Notice of Federal Tax Lien] balances the efficient collection of taxes with your legitimate concern that the collection action be no more intrusive than necessary.” This is the only IRM guidance available to Hearing Officers when considering the appropriate use of the balancing test. As explained above, Hearing Officers are required to write a determination in the form of an Appeals Case Memo (ACM) in which they should document that balancing was considered.<sup>23</sup> There is little guidance on how to actually perform the balancing test in a meaningful way to ensure that the collection action is no more intrusive than necessary.

18 IRC § 6330(c)(3)(C). See also H.R. REP. NO. 105-599, at 263 (1998) (Conf. Rep.); S. REP. NO. 105-174, at 68 (1998) (stating that “a proposed collection action should not be approved solely because the IRS shows that it has followed appropriate procedures.”).

19 The term “hearing officer” is an umbrella term to describe a group of employees who deal with taxpayers and resolve disputes. An Appeals hearing officer is any Settlement Officer, Appeals Officer, Appeals Account Resolution Specialist or other employee holding hearings, conferences or who otherwise resolves open case issues in Appeals. This term refers to individuals who conduct or review administrative hearings or who supervise hearing officers. Appeals Judicial Approach and Culture (AJAC) principles apply to hearing officers. IRS, AJAC FAQs, available at <http://appeals.web.irs.gov/about/ajac-faq.htm#General> (updated July 7, 2014).

20 IRC § 6330(c).

21 IRM 8.22.9.6.4 (Nov. 13, 2013).

22 IRM 8.22.9.6.7 (1) (Nov. 13, 2013).

23 IRM 8.6.2.1 (Mar. 21, 2012); 8.22.9.6.7(1) (Nov. 13, 2013). See also Form 5402, *Appeals Transmittal and Case Memo*.

In its response to the TAS information request, Appeals stated, “CDP cases can be reviewed by the Tax Court, but only for abuse of discretion, not on actual case resolution.”<sup>24</sup> The Tax Court applies this standard pursuant to legislative history.<sup>25</sup> Under the abuse of discretion standard, the Tax Court must give deference to an IRS Appeals determination unless it is “arbitrary, capricious, clearly unlawful, or without sound basis in fact or law.”<sup>26</sup> The abuse of discretion standard is consistent with the general principle that courts should not be in the business of second-guessing day-to-day government management; thus, the courts only overrule IRS CDP determinations where there are clear abuses.

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**The courts’ abuse of discretion standard of judicial review does not provide Appeals a carte blanche to make a *pro forma* or boilerplate determination avoiding any analysis of balancing factors intended by Congress ... Congress inserted the balancing test at the Appeals hearing level to prevent arbitrary, capricious, clearly unlawful, excessive, and harmful collection actions, and to enhance taxpayer protections; not just to provide deference to the IRS collection action.**

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However, the courts’ abuse of discretion standard of judicial review does not provide Appeals a carte blanche to make a *pro forma* or boilerplate determination avoiding any analysis of balancing factors intended by Congress. Nor does the abuse of discretion mean that the IRS should not learn from the courts’ analysis of balancing the government’s interest to collect taxes with legitimate concerns of the taxpayer that the proposed collection action is no more intrusive than necessary. In a number of cases, some of which are discussed below, even where the abuse of discretion standard is not met, the courts noted where the IRS had not done balancing of factors properly and remanded for further consideration.<sup>27</sup>

As stated above, Congress inserted the balancing test at the Appeals hearing level to prevent arbitrary, capricious, clearly unlawful, excessive, and harmful collection actions, and to enhance taxpayer protections; not just to provide deference to the IRS collection action.

Heavily relying on this standard of review and case law favorable to the government, IRM 8.22.4.2.1 states the “Tax Court’s standard of review for non-liability CDP determinations is to consider whether Appeals’ factual and legal conclusions reached at a CDP hearing are reasonable, *not whether they are*

24 National Taxpayer Advocate 2013 Annual Report to Congress 155-64. See also IRS Office of Chief Counsel, Memorandum CC-2014-002, *Proper Standard of Review for Collection Due Process Determinations* (May 5, 2014).

25 “Where the liability is not properly at issue, the appeals officer’s determinations should be reviewed for an abuse of discretion.” H.R. REP. NO. 105-599, at 266 (1998) (Conf. Rep.); see also *Goza v. Comm’r*, 114 T.C. 176 (2000). The application of the balancing test is also subject to abuse of discretion review. *Richter v. United States*, 2002-2 USTC ¶50,607 (C.D. Cal. 2002). In its review of CDP case law, TAS found the majority of cases discussing the balancing test favorable to the IRS. See, e.g., *Dalton v. Comm’r*, 682 F.3d 149 (1st Cir. 2012) (reversing the Tax Court and holding that a deferential standard of review is appropriate).

26 See *Duarte v. Comm’r*, T.C. Memo 2014-176 at \*10. See also *Bartley v. United States*, 343 F. Supp. 2d 649, 652 (N.D. Ohio 2004); *Robinette v. Comm’r*, 123 T.C. 85, 93 (2004), *rev’d*, 439 F.3d 455 (8th Cir. 2006); *Woodral v. Comm’r*, 112 T.C. 19, 23 (1999); *Blondheim v. Comm’r*, T.C. Memo. 2006-216.

27 See, e.g., *Budish v. Comm’r*, T.C. Memo 2014-239; *Eichler v. Comm’r*, 143 T.C. No. 2 (2014); *Isley v. Comm’r*, 141 T.C. 349 (2013); *Crosswhite v. Comm’r*, T.C. Memo. 2014-179; *Lofgren Trucking Service, Inc. v. United States*, 508 F. Supp. 2d 734 (D. Minn. 2007).

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...Congress intended that Appeals “provide a place for taxpayers to turn when they disagree with the determination of frontline employees” by taking “a fresh look at taxpayers’ cases, rather than merely rubber-stamping the earlier determination.”

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*correct*; and, the reasonableness of Appeals ultimate decision” (emphasis added).<sup>28</sup> In contrast, Appeals liability cases use “hazards of litigation” to determine settlement options. “A ‘hazards’ settlement is an intermediate resolution of an issue based on the fact that there is substantial uncertainty in the event of litigation.”<sup>29</sup> It appears that the IRS considers the risk that it will not prevail on a particular issue at trial (or “hazards of litigation”) only “in a small percentage of [non-liability] cases.” Finally, in its response to the National Taxpayer Advocate’s 2013 recommendation to require all AOs, Settlement Officers, and Appeals Account Resolution Specialists to take updated training on conducting the balancing test and applying the hazards of litigation, the IRS Office of Appeals maintains it already trains its employees on the recommended topics.<sup>30</sup>

TAS’s analysis of Appeals IRM provisions reveal a lack of guidance as to specific factors that should be considered when applying the balancing test. As a result, the IRS does not give the balancing test proper emphasis as intended by Congress in RRA 98. In addition, the lack of specific guidance may cause inconsistencies in applying the balancing test, erode core taxpayer rights, and could undermine future compliance.<sup>31</sup> Thus, Appeals should identify specific factors for the application of the balancing test. Ideally, these factors would be developed from an analysis of court decisions and legislative history discussing the balancing test, would consider all available evidence from taxpayers, and should verify that the Collection function gave all proper considerations prior to an appeal.

### Appeals should revise its current procedures that allow deference to collection.

The Appeals IRM lacks guidance regarding administrative policies and procedures for determining the appropriateness of collection actions and considering alternatives to enforced collection in CDP cases. Appeals employees are advised to use the Collection IRM to:

- Verify whether administrative procedures were followed in issuing a Notice of Intent to Levy and/or filing a Notice of Federal Tax Lien (NFTL);
- Review Collection case actions and decisions, taking into account any special circumstances; and
- Evaluate alternatives to collection action or challenges to appropriateness of collection.<sup>32</sup>

While it is reasonable for Hearing Officers to review the Collection IRM to ensure Collection follows proper administrative procedures, Appeals needs its own separate and detailed guidelines when reviewing CDP cases, particularly guidelines for the application of the balancing test. Congress specifically required

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28 IRM 8.22.4.2.1(2) (Nov. 5, 2013).

29 *Hazards of Litigation – Settlement Practice*, Appeals Training 22924-002 (May 2007) at 15.

30 National Taxpayer Advocate FY 2015 Objectives Report to Congress, Vol. 2, at 64 (IRS Responses and National Taxpayer Advocate’s Comments Regarding Most Serious Problems Identified in 2013 Annual Report to Congress).

31 The analysis of appropriate factors during performance of the balancing test is even more important during equivalent hearings because the taxpayer cannot receive judicial review of the equivalent hearing, except for innocent spouse issues, abatement of interest issues, and the timeliness of the CDP hearing request. See Treas. Reg. 301.6330-1(i). A taxpayer who does not request a CDP hearing under IRC § 6330 within the 30-day period is not entitled to a CDP hearing, but is entitled to an equivalent hearing with Appeals. *Id.*

32 See Memorandum for Appeals Employees, Control No. Ap-08-0713-03, *Implementation of the Appeals Judicial Approach and Culture (AJAC) Project* (July 18, 2013) (revising IRM 8.22.4.2.1). See also IRM 8.22.4.2.1(5) (Nov. 5, 2013).

an independent Appeals Officer (AO) to review the case.<sup>33</sup> RRA 98 established an Office of Appeals that would not “be influenced by tax collection employees and auditors.”<sup>34</sup> Further, Congress intended that Appeals “provide a place for taxpayers to turn when they disagree with the determination of frontline employees” by taking “a fresh look at taxpayers’ cases, rather than merely rubber-stamping the earlier determination.”<sup>35</sup> By saying an independent AO should look at the case and by defining specific elements to look at, Congress wanted Appeals to bring a different perspective—a Due Process perspective, not just a revenue raising or collection perspective. In other words, Congress wanted something more from the AO than merely following the Collection IRM.

The National Taxpayer Advocate recommended in her 2013 Annual Report to Congress that Appeals draft its own guidance on how to evaluate the appropriateness of proposed collection actions.<sup>36</sup> Appeals responded by claiming IRM 8.22 already contains the recommended guidance.<sup>37</sup> But directing Appeals employees to the Collection IRM contributes to the appearance that Appeals is “rubber stamping” prior determinations made by Collection, because Collection does not contemplate the factors under the balancing test. The IRS files many NFTLs systemically, pursuant to “business rules” that require automatic NFTL filing or a lack of substantive human review.<sup>38</sup> In FY 2014 alone, Collection filed 535,580 liens and issued 1,995,987 levies.<sup>39</sup> The Appeals mission cannot be accomplished if, in either fact or appearance, it is an extension of the Examination or Collection divisions. It is critical that Appeals not be viewed by taxpayers as an adversary seeking to reaffirm Collection determinations.

### The IRS Should Incorporate the Balancing Test Analysis into the Collection IRM.

Four sections of the Collection IRM now mention the concept of balancing as a result of TAS negotiations with the IRS Collection function, and as a part of meaningful incorporation of TBOR provisions

33 Section 1001(a)(4) of RRA 98 provides that the Commissioner’s plan to reorganize the IRS shall “ensure an independent appeals function within the Internal Revenue Service.” RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998). See also IRC §§ 6159(e) and 7122(e) (providing for an “independent administrative review” of installment agreements and offers in compromise that the IRS has construed as meaning an opportunity for a hearing with Appeals).

34 144 CONG. REC. S4182 (1998) (statement of Sen. Roth) (stating also that “the taxpayers who get caught in the IRS hall of mirrors have no place to turn that is truly independent and structured to represent their concerns.”).

35 144 CONG. REC. S7639 (1998) (statement of Sen. Jeffords). See, e.g., *Budish v. Comm’r*, T.C. Memo 2014-239 (stating that the Appeals Officer “felt constrained to require a notice of lien filing by virtue of what she erroneously considered the mandate of the IRM and that the inclusion of her statement that petitioner “failed to show” that not filing of a notice of lien would be in the Government’s best interest and facilitate collection was, in effect, surplusage or boilerplate, included merely for the sake of completeness.”).

36 National Taxpayer Advocate 2013 Annual Report to Congress 155-64.

37 National Taxpayer Advocate FY 2015 Objectives Report to Congress, Vol. 2, at 64 (IRS Responses and National Taxpayer Advocate’s Comments Regarding Most Serious Problems Identified in 2013 Annual Report to Congress).

38 See Most Serious Problem: *MANAGERIAL APPROVAL FOR LIENS: The IRS’s Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98* and need to select *infra*. Lien filing is subject to dollar liability thresholds. IRM 5.12.2.6 advises that, in general, liens should be filed when the aggregate unpaid balance of assessment is \$10,000 or more. Collection does not consider individual facts and circumstances. See also IRM 5.19.4.5.3.2 (Aug. 4, 2014). In FY 2011, the IRS modified the criteria used in filing NFTLs, issued expanded guidance enabling more taxpayers to request and obtain lien withdrawals, expanded the criteria under which small businesses may pay past due taxes in installments, and formalized the “streamlined” offer in compromise (OIC) procedures used by the IRS’s centralized OIC operation. IR-2011-20, Feb. 24, 2011.

39 IRS, Collection Activity Report 5000-25, *Liens Report* (Dec. 2014) and Collection Activity Report 5000-24, *Levy and Seizure Report* (Sept. 2014).

into the IRM.<sup>40</sup> For instance, IRM 5.1.9.3.10 explains the Appeals determination process using the “Big Three” review. IRM 5.12.2.3 provides pre-filing considerations when making a lien determination and specifically states:

IRC § 6320 requires the IRS to insure collection actions, including the decision to file an NFTL, balance the need for efficient collection of the tax with legitimate concerns of the taxpayer that actions be *no more intrusive than necessary*. To that end, review the factors contained in this IRM section and related subsections to reach the appropriate decision.<sup>41</sup>

These revisions are a positive step toward protecting taxpayer rights. The IRS should continue to revise all appropriate Collection IRM sections to include the balancing test and require the analysis of balancing test factors during consideration of enforced collection actions.<sup>42</sup>

By incorporating the balancing test into the Collection IRM:

- Balancing test factors can be addressed earlier in the collection process;
- Collection actions will not be taken where they are more intrusive than necessary;
- It will be evident to taxpayers that TBOR is a focal point for the IRS;
- Future Appeals workloads will be reduced; and
- Appeals will find it easier to verify that Collections has taken the proper steps.

**Courts’ analyses of the balancing test could be a starting point for developing proper balancing test procedures.**

In its review of CDP case law, TAS found the vast majority of balancing test related cases ruled in favor of the IRS notwithstanding the IRS merely stated (without elaboration or proper analysis) in these cases

40 See IRM 5.14.1.4, *Installment Agreement Acceptance and Rejection Determinations* (Sept. 19, 2014); 5.19.4.5.1, *Notice of Federal Tax Lien Filing Determinations* (Aug. 4, 2014); 5.1.9.3.10, *Appeals Determination* (Feb. 7, 2014); and 5.12.2.3, *Notice of Federal Tax Lien Filing Determination (Pre-filing Considerations)* (Oct. 14, 2013). In 2013, the National Taxpayer Advocate convened a Taxpayer Rights IRM Review Team to undertake a comprehensive audit of all non-administrative IRM sections and to recommend revisions to enhance taxpayer rights. On June 10, 2014, the IRS adopted the TBOR that the National Taxpayer Advocate has long advocated, pulling together in one basic statement the principles that underlay the substantive rights scattered throughout the Internal Revenue Code.

41 The National Taxpayer Advocate addressed most serious problems facing taxpayers as a result of IRS lien filing policies in her 2009, 2010, 2011, 2012, and 2013 Annual Reports to Congress. See National Taxpayer Advocate 2013 Annual Report to Congress 84-93; National Taxpayer Advocate 2012 Annual Report to Congress 403-25; National Taxpayer Advocate 2011 Annual Report to Congress 109-28; National Taxpayer Advocate 2010 Annual Report to Congress 85-97; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. See also Most Serious Problem: MANGERIAL APPROVAL FOR LIENS: *The IRS’s Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98 infra*.

42 In 2015, the National Taxpayer Advocate’s Taxpayer Rights IRM Review Team, in conjunction with TAS Internal Management Documents Single Point of Contact (IMD SPOC), will continue to review the IRM subsections identified as “high impact” and recommend revisions to strengthen taxpayer rights. National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 12-21.

...Congress wanted Appeals to bring a different perspective—a Due Process perspective, not just a revenue raising or collection perspective. In other words, Congress wanted something more from the Appeals Officer than merely following the Collection Internal Revenue Manual.

that the balancing test had been performed.<sup>43</sup> There was little scrutiny or in-depth review, if any, from most courts regarding Appeals’ analysis, which the National Taxpayer Advocate believes should set forth in each case precisely how an AO balanced the taxpayer’s concerns with the government’s interest to collect.<sup>44</sup> TAS believes this result is largely due to the abuse of discretion judicial standard of review discussed in more detail above.

However, in a few opinions, the courts applied scrutiny to the performance of the balancing test and sought to determine whether the IRS engaged in a proper analysis of the test.<sup>45</sup> Noteworthy was *Mesa Oil, Inc. v. United States*,<sup>46</sup> where the court held the balancing test had not been properly conducted by the IRS because the Appeals Officer’s determination letter lacked any description of the analysis performed.<sup>47</sup> The court firmly rejected a “*blank recitation*” that the balancing test had been performed, deemed the entire Appeals record insufficient for judicial review, and remanded the case to Appeals.<sup>48</sup> Similarly, in *Lofgren Trucking Serv., Inc. v. United States*,<sup>49</sup> the court noted that the AO did not cite any balancing factors, and did not provide basis for his summary rejection of the installment agreement proposed by the taxpayer. As a result, the court concluded the taxpayer “was deprived of its right to a fair hearing under [IRC] § 6330(b)” and remanded the case to Appeals.<sup>50</sup>

43 See *Living Care Alternatives of Utica v. United States*, 411 F.3d 621, 625 (6th Cir. 2005) (“Judicial review of collection due process hearings presents a real problem for reviewing courts. Congress overlaid the Restructuring and Reform Act on a previous system that involved very little judicial oversight. The result is a surprisingly scant record, comprised almost exclusively of the parties’ appellate briefs and the Notice of Determination letter. No transcript or official record of the hearing is required and, accordingly, one rarely exists. Since normal review of administrative decisions requires the existence of a record, [case citations omitted] ... Congress must have been contemplating a more deferential review of these tax appeals than of more formal agency decisions. This might explain why, of six collection due process cases reviewed by the Sixth Circuit, five have been disposed of under our Court’s Rule 34 and all six have been unpublished. None has overturned the IRS decision or required a remand.”). See also *Robinette v. Comm’r*, 439 F.3d 455 (8th Cir. 2006) (concluding that the balancing test had been performed because Appeals Officer specifically referred to it in his memorandum); *Elliott v. United States*, 98 A.F.T.R.2d (RIA) 8182 (S.D. Tex. 2006) (following *Robinette*’s conclusion in regards to the balancing test); *Eby v. Comm’r*, 97 A.F.T.R.2d (RIA) 1747 (S.D. Ohio 2006).

44 See, e.g., *Living Care Alternatives of Utica v. United States*, 411 F.3d 621, 627 (6th Cir. 2005) (stating that “[i]n most cases, reviewing courts have merely affirmed the Appeals Officer’s determination that [Appeals Officer] conducted the balancing test and that he found the results to be consistent with the decision to proceed with levying the property.”).

45 See *Mesa Oil, Inc. v. United States*, 86 A.F.T.R.2d 2000-7312 (D. Colo.) (unpublished); *Cox v. United States*, 345 F. Supp. 2d 1218 (W.D. Okla. 2004); *Lofgren Trucking Serv., Inc. v. United States*, 508 F. Supp. 2d 734 (D. Minn. 2007); *Isley v. Comm’r*, 141 T.C. 349 (2013); *Fifty Below Sales & Marketing, Inc. v. United States*, 497 F.3d 828 (8th Cir. 2007).

46 86 A.F.T.R.2d 2000-7312 (D. Colo.) (unpublished). *Mesa Oil*, however, did not set a wide case law precedent and remains an unpublished opinion.

47 86 A.F.T.R.2d 2000-7312 (D. Colo.) (unpublished) at \*4.

48 *Id.* (stating that “The [Appeal Officer’s] Determination’s blank recitation of the statute gives no indication that the statutory goal of a “meaningful hearing” was accomplished, or that actual balancing occurred. Instead, the sparse [Appeals Officer’s] determination gives every indication that the “proposed collection action was approved solely because the IRS show[ed] that it ha[d] followed appropriate procedures.” The Senate committee report emphasized, “a proposed collection action should not be approved solely because the IRS shows that it has followed appropriate procedures.” S. REP. NO. 105-174, at 68 (1998). In a more recent 2014 lien and levy case, *Duarte v. Comm’r*, T.C. Memo. 2014-176, the Tax Court also remanded a case to Appeals for presenting an insufficient record regarding negotiations over an offer-in-compromise and whether it had been properly considered as a collection alternative.

49 508 F. Supp. 2d 734 (D. Minn. 2007).

50 508 F. Supp. 2d 739-40 (D. Minn. 2007). The court found the AO “failed to meet his obligation to adequately consider whether plaintiff’s proposed installment agreement balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary” [under 26 U.S.C. § 6330(c)(3)(C)] and “[i]n doing so, [the Appeals Officer] clearly abused his discretion, rendering his decision improper.” (internal citations omitted).

Albeit a CDP case with an IRS victory, *Fifty Below Sales & Marketing, Inc. v. United States* contains a good depiction of what the balancing test might entail.<sup>51</sup> The opinion discussed the balancing test at length and provided at least four factors Appeals Officers should contemplate in conducting the balancing test, namely:

1. The taxpayer's ability to pay in accordance with the taxpayer's proposal;<sup>52</sup>
2. The size of the taxpayer's liability;
3. The taxpayer's record of fulfilling obligations under any previous collection alternative agreements; and
4. The taxpayer's compliance with current obligations.

In an important recent decision in *Budish v. Commissioner*, the United States Tax Court further developed the factors to be considered in conducting the balancing test.<sup>53</sup> The court remanded the case to Appeals for a supplemental CDP hearing with directions to perform the balancing of factors required by law before determining the appropriate collection action, including:

1. The impact of a proposed collection action [notice of federal tax lien] on the taxpayer's ability to remain in business and generate sufficient income to not default on the proposed installment agreement;
2. The value of the taxpayer's assets and the amount of cash flow;
3. Any reasonable alternatives to the proposed collection action [*e.g.*, a bond in lieu of the NFTL] under the circumstances; and
4. The validity and the priority of the lien and whether it will attach to the taxpayer's assets.<sup>54</sup>

These court opinions are a good starting point for developing meaningful balancing test factors that would address the inconsistencies, vagueness of application, and emphasize the significance of taxpayers perceiving the CDP hearing as fair and impartial analysis from the Office of Appeals as intended by Congress. The National Taxpayer Advocate believes Appeals would benefit from analyzing court decisions, such as the ones cited above, to identify what factors should contribute to a Hearing Officer's proper performance of the balancing test, and incorporate those factors into Appeals (and Collection) IRMs. TAS offers its assistance to Appeals in defining these factors.

51 *Fifty Below Sales & Marketing, Inc. v. United States*, 497 F.3d 828 (8th Cir. 2007). In this case, the taxpayer, an Internet marketing and design firm behind on its employment taxes, appealed two District Court decisions permitting the IRS to levy. The taxpayer argued the IRS failed to consider the taxpayer's current ability to make payments on a new installment agreement and did not properly balance competing interests as required by the balancing test. The court disagreed. The court found the Appeals Officer did not rely on erroneous facts, did consider the taxpayer's current and past compliance histories, considered the multi-million dollar size of the liability, and provided an adequate analysis in the Notice of Determination. The IRS levies were sustained.

52 TAS believes this element would include special facts and circumstances analysis similar to innocent spouse or effective tax administration offer in compromise analysis. See, *e.g.*, IRM 5.8.11, *Offer in Compromise, Effective Tax Administration* (Nov. 26, 2013).

53 T.C. Memo 2014-239.

54 *Budish v. Comm'r*, T.C. Memo 2014-239.

### Appeals' Judicial Approach and Culture (AJAC) initiative provides an opportunity for developing training on the CDP balancing test.

To address increasing internal (including the National Taxpayer Advocate) and external (from taxpayers and their representatives) concerns regarding the independence of Appeals, the IRS recently created the Appeals Judicial Approach and Culture (AJAC) initiative. AJAC consists of a multi-functional project team, convened to review existing policies and procedures.<sup>55</sup> AJAC is tasked with emphasizing the “quasi-judicial” role of Appeals, so that Appeals employees can more easily focus on its core mission, which is fair and impartial decision-making.

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The balancing test recognizes the Supreme Court's maxim in *Bull v. United States* that “taxes are the lifeblood of the government,” but also acknowledges that it is the taxpayers who provide that lifeblood.

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AJAC attempts to achieve this goal by clarifying the separation between Examination and Collection on the one hand, and Appeals on the other hand. AJAC's provisions are intended to highlight the distinctions between Appeals and other IRS functions by carefully articulating and segregating the activities to be performed by Appeals. In this way, Appeals can more transparently focus on its role of negotiating appropriate, unbiased resolutions of the controversies that come before it.<sup>56</sup>

Despite its stated goal of enhancing the independence of Appeals and impartial decision-making, the National Taxpayer Advocate is increasingly concerned about how AJAC is being used as an excuse for Appeals not to engage with the taxpayer. Appeals appears to be using its self-declared “quasi-judicial” label to justify using the narrow abuse of discretion standard in its own CDP hearings, contrary to congressional directive. Because IRS Collection personnel frequently issue premature CDP notices without appropriate fact-finding and analysis,<sup>57</sup> under AJAC taxpayers end up bouncing back and forth like ping-pong balls between Appeals and Collection. Accordingly, the National Taxpayer Advocate has identified AJAC as a potential Most Serious Problem facing taxpayers for the 2015 Annual Report to Congress and is looking forward to working with the IRS on revising the initiative to avoid harm to taxpayers. For a start, Appeals should seize the opportunity to integrate the analysis of the CDP balancing test factors into the AJAC initiative.

## CONCLUSION

Congress intended for the IRS to provide meaningful CDP hearings to taxpayers weighing their concerns that any collection action be no more intrusive than necessary with the government's need for the efficient collection of taxes. By not applying the balancing test consistently, the IRS is missing opportunities to improve compliance, enhance taxpayer trust and confidence, and relieving undue burden on taxpayers, giving true meaning to TBOR. The lack of consistent guidance in the application of the balancing test undermines the Congressional intent to enhance taxpayer protections through CDP hearings and is eroding core taxpayer rights. The National Taxpayer Advocate urges the IRS to re-evaluate its approach to applying the balancing test, as well as further defining the factors considered, and to use this opportunity to give TBOR real meaning through the development of specific guidance and by delivering this training to employees as a part of AJAC.

55 IRS intranet, *What is AJAC?*, available at <http://appeals.web.irs.gov/about/what-is-ajac.htm> (updated Oct. 24, 2013).

56 IRS intranet, *Overall AJAC Talking Points*, available at <http://appeals.web.irs.gov/about/ajac.htm> (updated July 2, 2014).

57 See National Taxpayer Advocate 2013 Annual Report to Congress 157.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, formulate a policy statement on the CDP balancing test based on congressional intent.
2. In collaboration with TAS, develop specific factors for the application of the CDP balancing test based on an analysis of case law and legislative history for use by both Appeals and Collection.
3. Revise the IRM to specifically prohibit *pro forma* statements that the balancing test has been performed, and instead require a description of what factors were considered and how they apply in the particular taxpayer's case.
4. Integrate any newly developed factors for the application of the CDP balancing test into the Appeals IRM and train all Appeals Officers, Settlement Officers, and Appeals Account Resolution Specialists on applying the balancing test consistently.
5. Incorporate balancing test analysis into the Collection IRM and provide necessary training to Collection employees.

**MSP  
#19****FEDERAL PAYMENT LEVY PROGRAM: Despite Some Planned Improvements, Taxpayers Experiencing Economic Hardship Continue to Be Harmed by the Federal Payment Levy Program****DEFINITION OF PROBLEM**

The Federal Payment Levy Program (FPLP) is an automated system the IRS uses to match its records against those of the government's Bureau of the Fiscal Service (BFS) to identify taxpayers with unpaid tax liabilities who receive certain payments from the federal government. Internal Revenue Code (IRC) § 6331 allows the IRS to issue continuous levies for up to 15 percent of federal payments due to these taxpayers who have unpaid federal liabilities.<sup>1</sup>

In January 2011, at the insistence of the National Taxpayer Advocate, the IRS began applying a low income filter (LIF) to the FPLP to screen out taxpayers whose incomes are below 250 percent of the federal poverty level.<sup>2</sup> The purpose of this filter is to protect low income taxpayers from economic hardship due to a levy on their Social Security old age or disability benefits, or Railroad Retirement Board benefits. The filter was implemented after research by the Taxpayer Advocate Service (TAS) demonstrated that the FPLP program levied on taxpayers who were experiencing economic hardship.<sup>3</sup> The filter ensures the IRS does not issue levies it would be required by law to release because of the taxpayer's economic hardship.

However, under current LIF exclusion criteria, if IRS records indicate the taxpayer has an unfiled delinquent tax return (or returns) indicator on their account (*i.e.*, a tax delinquency investigation (TDI) indicator),<sup>4</sup> the account will bypass the LIF and leave the taxpayer subject to the FPLP.<sup>5</sup> In fiscal year (FY) 2014, 30,177 taxpayers whose income fell below 250 percent of the federal poverty level bypassed the LIF and were subjected to the FPLP for this very reason.<sup>6</sup> The median income for these taxpayers fell far below 250 percent of the federal poverty level. The median income for these taxpayers was \$17,515 as compared to the 2014 income level of \$29,175 for a single person at or below 250 percent of the federal poverty level.<sup>7</sup> Additionally, the records that indicate an unfiled return are not always accurate. In

- 1 IRC § 6331(h)(2)(A), as prescribed by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1024, authorizes the IRS to issue continuous levies on certain federal payments. The Bureau of the Fiscal Service (BFS) (formed from the consolidation of the Financial Management Service and the Bureau of the Public Debt) is the Department of Treasury agency that processes payments for various federal agencies. Payments subject to FPLP include any federal payments other than those for which eligibility is based on the income or assets of the recipients.
- 2 Department of Health and Human Services (DHHS), *The 2014 HHS Poverty Guidelines*, available at <http://aspe.hhs.gov/poverty/14poverty.cfm>. The federal poverty level is set by the DHHS. For calendar year 2014, an individual who makes \$11,670 or less is in poverty. This number is then multiplied by 250 percent to determine the 250 percent federal poverty threshold. See also Internal Revenue Manual (IRM) 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (June 23, 2014). The poverty level is based on household size, computed from the number of exemptions claimed on the tax return. Household size is set to one if a current return is not filed.
- 3 National Taxpayer Advocate 2008 Annual Report to Congress Vol. 2, 46-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).
- 4 IRM 5.19.2.1, *What Is the Return Delinquency Program?* (Sept. 11, 2012). The IRS does not place all unfiled return modules in TDI status.
- 5 IRM 5.11.7.2.2.3, *Low Income Filter (LIF) Exclusion* (Aug. 28, 2012).
- 6 Information Returns Master File and the Individual Master File and Accounts Receivable Dollar Inventory.
- 7 *Id.* DHHS, *The 2014 HHS Poverty Guidelines*, available at <http://aspe.hhs.gov/poverty/14poverty.cfm>.

fact, of all the accounts that had a TDI indicator, 21 percent did not actually have a delinquent return.<sup>8</sup> Thus, it is possible that the IRS incorrectly excluded more than a fifth of the taxpayers from the LIF because of incorrect input of the unfiled return indicator. Moreover, excluding these taxpayers from the LIF and failing to consider their financial circumstances is contrary to the IRS's own pre-levy determination guidance, which requires IRS employees to consider hardship before issuing a levy.<sup>9</sup> When the IRS fails to consider taxpayers' financial circumstances by having them bypass the LIF, it undermines their *right to privacy* and their *right to a fair and just tax system*.<sup>10</sup>

The IRS justifies excluding taxpayers with unfiled returns from the LIF by noting that:

- The IRS equates the determination of economic hardship with the taxpayer's eligibility for a collection alternative, which requires taxpayers to file delinquent returns before entering into an installment agreement or an offer in compromise. The National Taxpayer Advocate believes this explanation improperly conflates the determination of economic hardship with the eligibility for a collection alternative.
- In the absence of a return, the IRS cannot determine the taxpayer's income level.<sup>11</sup> However, the IRS routinely uses third-party information to determine taxpayer's income to assess additional tax against a taxpayer.

The IRS has recently improved the FPLP process, most notably by agreeing to exclude all Social Security Disability Insurance (SSDI) payments from the FPLP program.<sup>12</sup> The IRS also recommended a change that would apply the Low Income Filter (LIF) to taxpayers with one or more TDI indicators on their account when the taxpayer: 1) is over 65 years of age, 2) has filed an income tax return for at least one of the last three tax years, and 3) the IRS has not identified a potential delinquent return after the last filed return.<sup>13</sup> This recommendation would only apply to about ten percent of taxpayers who have income below 250 percent of the federal poverty level and who have a TDI indicator on their account being included in the LIF.<sup>14</sup> Therefore, the National Taxpayer Advocate remains concerned that the unfiled return

8 IRS, Collection Activity Report, NO-139, *Delinquent Return Activity Report* (Sept. 2014). This percentage was determined using modules. Therefore, the exact percentage of taxpayers with a TDI on their account is uncertain. Note: a taxpayer may be liable for tax, even though the TDI account was closed as "not liable." For example, the IRS may place a TDI on the taxpayer's account, because it never received an individual tax return from the taxpayer, which he or she has filed in past years. However, the taxpayer filed a joint return as the secondary taxpayer. In this case, the TDI will be closed as "not liable," but the taxpayer may have in fact had a liability, but it was associated with the joint return.

9 IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014).

10 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. See also IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

11 Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, Taxpayer Advocate Directive (TAD) 2012-2, *Low Income Filter in the Federal Payment Levy Program* (Dec. 20, 2013).

12 SSDI pays benefits to individuals and certain members of their families, if the individual worked long enough and paid Social Security taxes. See Social Security, Benefits for People with Disabilities, available at <http://www.ssa.gov/disability/>. On October 6, 2014, the IRS formally requested that BFS exclude SSDI recipients from the FPLP Program. See Memorandum from Darren John Guillot, Director, Enterprise Collection Strategy, to Wanda Rogers, Deputy Commissioner, Bureau of the Fiscal Service, *Discontinuation of Offset of Disability Portion of Old Age, Survivor and Payments Against Outstanding Federal Debt* (Oct. 6, 2014). IRM 5.11.7.2.1.1, *IRS/FMS Interagency Agreement—Federal Payments Subject to the FPLP* (Aug. 28, 2011). Supplemental Security Income (SSI) payments, payments to disabled adults and children who have limited income and resources, are not subject to the FPLP. See also Supplemental Security Income (SSI) Benefits, available at <http://www.ssa.gov/disabilityssi/ssi.html>.

13 Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, *Low Income Filter in the Federal Payment Levy Program* (Mar. 25, 2014).

14 IRS, *Federal Payment Levy Program: Augmentation Proposals for the Low Income Filter (LIF) for Taxpayers with TDI Modules* (Jan. 7, 2014).

exclusion criterion continues to subject a large number of low income taxpayers to the FPLP, even if they are experiencing economic hardship.<sup>15</sup>

## ANALYSIS OF PROBLEM

### Background

The IRS has the authority to issue a continuous levy on a variety of federal sources of income, including Social Security and Railroad Retirement Board benefits, and since 2000 has automatically levied on these sources pursuant to the FPLP.<sup>16</sup> The IRS has long recognized most FPLP levy payments come from the Social Security benefits, and while acknowledging this population is particularly vulnerable, avoids levying on Social Security payments to low income taxpayers through implementation of the LIF.<sup>17</sup> Congress has also recognized the need to limit IRS collection authority for financially struggling taxpayers by passing IRC § 6343(a)(1)(D), which requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Further, the Tax Court has held that IRS cannot refuse to release such a levy merely because a taxpayer who is experiencing economic hardship hasn't filed all returns.<sup>18</sup>

### *The FPLP Has a Sweeping Effect on Social Security Recipients.*

As mentioned above, the majority of revenue collected by the FPLP program is from Social Security payments, which significantly reduces a taxpayer's monthly Social Security benefit. For example:

- In FY 2014, 76 percent of all FPLP dollars collected were from Social Security beneficiaries.
- 31 percent of all FPLP levies were on SSDI beneficiaries.<sup>19</sup>
- Taxpayers receiving SSDI income paid nearly \$108 million of over \$413 million of FPLP payments (or 26 percent).<sup>20</sup>

15 The National Taxpayer Advocate expressed concerns about how the IRS applies LIF exclusions in prior Annual Reports to Congress. See National Taxpayer Advocate 2013 Annual Report to Congress 84 (Most Serious Problem: *Hardship Levies: Four Years After the Tax Court's Holding in Vinatieri v. Commissioner, the IRS Continues to Levy on Taxpayers It Acknowledges Are in Economic Hardship and Then Fails to Release the Levies*); National Taxpayer Advocate 2011 Annual Report to Congress 350 (Most Serious Problem: *The New Income Filter for the Federal Payment Levy Program Does Not Fully Protect Low Income Taxpayers from Levies on Social Security Benefits*). National Taxpayer Advocate 2007 Annual Report to Congress; National Taxpayer Advocate 2006 Annual Report to Congress 110-29, 141-56; National Taxpayer Advocate 2005 Annual Report to Congress 123-35; National Taxpayer Advocate 2004 Annual Report to Congress 246-63; National Taxpayer Advocate 2003 Annual Report to Congress 206-12; National Taxpayer Advocate 2001 Annual Report to Congress 202-09.

16 IRC § 6331(h)(2); IRM 5.11.7.2.1.1(2), *IRS/FMS Interagency Agreement—Federal Payments Subject to the FPLP* (Aug. 28, 2012). Unlike other levies, a continuous levy on taxpayer's Social Security old age or disability benefits, or Railroad Retirement Board benefits has a continuing effect. It attaches to future payments until the levy is released. All other levies, except for levies on wages and salary under IRC § 6331(e), only attach to property and rights to property that exist at the time the levy is served.

17 The IRS's first attempt at a filter was removed in 2005. General Accounting Office (GAO, now the Government Accountability Office), GAO 03-356, *Tax Administration, Federal Payment Levy Payment Program Measures, Performance and Equity Can Be Improved* 13-15 (Mar. 6, 2003). The GAO in 2003 questioned the effectiveness of the filter, because the IRS filter did not recognize that taxpayers may not have recently filed a return, making data potentially dated and unreliable, and did not consider the possibility the taxpayer could have assets that could be used to pay the liability.

18 In *Vinatieri v. Comm'r*, 133 T.C. 392 (2009) the Tax Court held that it was an abuse of discretion for the IRS to proceed with a levy against a taxpayer who has unfiled returns if the taxpayer has shown he or she is in economic hardship.

19 Information Returns Master File Form 1099-SSA/RRB and Individual Master File on the IRS Compliance Data Warehouse.

20 *Id.*

- In 2014, the average amount levied on a taxpayer's SSDI payment each month was \$113.21 and the average monthly benefit payment for disabled workers was \$1,162<sup>21</sup>

*Recognizing the Impact FPLP Levies Have on Social Security Recipients, the IRS Adopted a Low Income Filter.*

When the IRS fails to consider taxpayers' financial circumstances by having them bypass the low income filter, it undermines their right to privacy and their right to a fair and just tax system.

As these figures illustrate, a FPLP levy can significantly reduce a taxpayer's Social Security payments, thereby impacting his or her financial circumstances. Recognizing this impact, the IRS, in 2011, implemented a low income filter. Its design was based on a TAS study, which tested a model that identified low income taxpayers who would experience economic hardship (*i.e.*, inability to pay basic living expenses) as a result of the levy and removed them from the FPLP.<sup>22</sup> Once economic hardship has been established, these taxpayers would be entitled to immediate levy release under IRC § 6343(a)(1)(D).<sup>23</sup> These findings suggested that without a filter a significant number of taxpayers could not afford a basic standard of living when subject to a levy on their Social Security Administration (SSA) benefits.<sup>24</sup>

After accepting the findings from the TAS study, the IRS designed a filter that excluded taxpayers whose incomes fall below 250 percent of the federal poverty level. These taxpayers are presumed to be experiencing an economic hardship as defined by IRC § 6343(a)(1)(D).<sup>25</sup> However, the IRS decided the filter would not cover all low income taxpayers. Taxpayers whose account(s) showed an unfiled return and a TDI indicator would bypass the LIF and be subject to the FPLP.<sup>26</sup>

21 Social Security Administration (SSA), Publication No. 13-11700, *Annual Statistical Supplement to the Social Security Bulletin* (Feb. 2014), available at <http://www.socialsecurity.gov/policy/docs/statcomps/supplement/>. This report only provided an average monthly SSDI payment for 2012. Therefore, TAS adjusted for inflation to reach an estimated monthly SSDI payment for 2014. Bureau of Labor Standards Inflation Calculator available at [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm)

22 IRC § 6343(a)(1)(D) requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Treas. Reg. § 301.6343-1(b)(4) specifies that an economic hardship exists if a taxpayer cannot pay his or her basic living expenses.

23 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*). The TAS model applied the IRS's formula for determining economic hardship to all taxpayer delinquent account cases subjected to an FPLP levy during the first six months of FY 2007. To identify low income taxpayers, the TAS model, in addition to using taxpayers' income information from tax returns, used third-party documents supplied to the IRS to estimate the taxpayers' incomes. The model then used other tax return data to estimate Allowable Living Expenses (ALE) (living expenses the IRS routinely allows when determining a taxpayer's ability to pay). TAS then performed additional analyses to explore the availability of other taxpayer assets to satisfy the liability and investigated whether IRS databases are sufficient to detect such available assets.

24 *Id.* at 57.

25 The IRS believed a more administrable measure, such as a minimum dollar amount of income, or income as a percentage of the federal poverty level, was needed as a proxy for economic hardship, rather than using an automating algorithm like the one TAS used in its research study to determine economic hardship. Therefore, the IRS proposed using 250 percent of the federal poverty level as the threshold for a filter in a meeting on October 6, 2009. IRS PowerPoint presentation, *Federal Payment Levy Program: Proposed Process to Implement Low Income Filter for Social Security and Railroad Retirement* (Sept. 29, 2009), presented to the National Taxpayer Advocate on Oct. 6, 2009. Note that 250 percent of federal poverty level is also the threshold Congress adopted in its definition of "low income taxpayers" for purposes of identifying taxpayers eligible for assistance from Low Income Taxpayer Clinics pursuant to IRC § 7526.

26 IRM 5.11.7.2.2.3, *Low Income Filter (LIF) Exclusion* (Aug. 28, 2012).

From the outset, the National Taxpayer Advocate had reservations with this final LIF design.<sup>27</sup> After unsuccessfully urging the IRS to eliminate the unfiled return exclusion, the National Taxpayer Advocate issued a Taxpayer Advocate Directive (TAD) on January 12, 2012. This directive instructed the IRS to adopt the following policy: “[t]axpayers whose incomes are below 250 percent of the federal poverty level set by the Department of Health and Human Services and who receive Social Security or Railroad Retirement Board Benefits should be screened out of the Federal Payment Levy Program, regardless of unfiled returns or outstanding business debts.” Almost two years after the National Taxpayer Advocate issued the TAD, the Deputy Commissioner for Services and Enforcement sustained the appeal of the portion of the TAD pertaining to unfiled returns, refusing to adopt the National Taxpayer Advocate’s position that the low income filter should cover these accounts.<sup>28</sup>

As a result, the IRS’s refusal to eliminate the LIF exclusion criteria for accounts with a TDI indicator has harmed thousands of taxpayers whose income falls below 250 percent of the federal poverty level. In FY 2014, 30,177 taxpayers with income levels below 250 percent of the federal poverty guidelines were excluded from the LIF and were subjected to the FPLP due to a TDI indicator on their accounts.<sup>29</sup> Additionally, the median income for these taxpayers was \$17,515.<sup>30</sup> This income is significantly below 250 percent of the federal poverty level, which is about \$29,175 for a single person in 2014.<sup>31</sup>

### **The TDI Indicator Exclusion from the LIF Is Contrary to Pre-Levy Determination Guidance and May Have Been Improperly Implemented.**

#### *Excluding Low Income Taxpayers from the LIF Because of a TDI Indicator on Their Accounts Is Inconsistent with IRS Levy Policy and Compromises a Taxpayer’s Right to a Fair and Just Tax System.*

Excluding taxpayers from the filter when their incomes fall below 250 percent of the federal poverty guidelines and they have a TDI indicator on their accounts is inconsistent with IRS levy policy. In the pre-levy consideration guidance for Revenue Officers (ROs), the IRS acknowledges that taxpayers have *the right to a fair and just tax system*, which means they can expect the tax system to consider facts and circumstances that might affect their ability to pay.<sup>32</sup>

To protect this right, Revenue Officers (ROs) are instructed to exercise good judgment when making the determination to levy, *i.e.*, to consider the taxpayer’s financial condition. In fact, prior to levying against any of these 30,177 taxpayers’ payments,<sup>33</sup> an RO would have to adhere to this guidance and properly consider the taxpayer’s facts and circumstances (*e.g.*, whether the levy would cause economic hardship). In contrast, in the context of an FPLP levy, the IRS does not consider the taxpayer’s particular facts and

27 National Taxpayer Advocate 2011 Annual Report to Congress 350 (Most Serious Problem: *The New Income Filter for the Federal Payment Levy Program Does Not Fully Protect Low Income Taxpayers from Levies on Social Security Benefits*); National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 46-72 (*Building a Better Filter: Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*); Taxpayer Advocate Directive 2012-2 (Jan. 12, 2012).

28 See Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, TAD 2012-2, *Low Income Filter in the Federal Payment Levy Program* (Dec. 20, 2013). Although the IRS has declined to eliminate the criteria excluding taxpayers with an unfiled return from the LIF, it has agreed to eliminate the criterion that excludes taxpayers who have a business debt. The IRS is working on the programming for this removal.

29 Information Returns Master File and the Individual Master File and Accounts Receivable Dollar Inventory.

30 Information Returns Master File and the Individual Master File.

31 DHHS, *The 2014 HHS Poverty Guidelines*, available at <http://aspe.hhs.gov/poverty/14poverty.cfm>.

32 IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014).

33 Information Returns Master File and the Individual Master File and Accounts Receivable Dollar Inventory.

circumstances when a taxpayer has a TDI indicator on his or her account (*i.e.*, the IRS does not consider whether the taxpayer's income falls below 250 percent of the federal poverty guidelines).

***It is Unclear Whether the IRS Has Properly Implemented the Current LIF Exclusion, Resulting in Unintended Consequences to Low Income Taxpayers Who Do Not Have a TDI Account.***

A recent IRS study raised questions about why certain taxpayers had been excluded from the LIF while others were not.<sup>34</sup> In an attempt to answer this question, the TAS research team reviewed accounts excluded from the filter for the period ranging from January to August 2013. At the time of this writing, TAS has reviewed about 150,000 accounts, and has identified over 1,000 accounts excluded from the LIF for unknown reasons. TAS Research is continuing to analyze this data in hopes of identifying the precise reasons why these accounts were excluded from the LIF.

The IRS, in certain situations, will place a TDI code on a taxpayers account when they have not filed a return and information shows the taxpayer received income. The IRS places the TDI code on the account and initiates an investigation.<sup>35</sup> However, in many of these investigations, the TDI is eventually closed as “not liable” or “little or no tax due.” In FY 2014, the IRS closed 2,270,677 TDI modules.<sup>36</sup> Of these, 16 percent (371,030) were closed as “not liable.”<sup>37</sup> Another five percent were closed as “return filed” (115,502), which means the investigation discovered a return had in fact been filed.<sup>38</sup> This means 21 percent of the taxpayers did not have a delinquent return.<sup>39</sup> Because 21 percent of returns with a TDI code are not actually nonfilers or owe only little to no tax, the TDI indicator is not a reliable way to identify taxpayers who have an unfiled return on their account. Therefore, the TDI code should not be used to filter out taxpayers from the LIF filter—the risk of harming low income taxpayers is too great.

**IRS Justification for Excluding Taxpayers with Unfiled Returns from the LIF Is Unsound.**

Despite the above concerns regarding the LIF, the IRS has remained unwilling to eliminate the LIF's unfiled return exclusion criteria.<sup>40</sup> In its response to the Taxpayer Advocate Directive, the IRS raised two objections to including in the filter the accounts of taxpayers whose income is below 250 percent of the federal poverty guidelines but who have a TDI indicator on their accounts:

1. Failing to file a return and comply with filing requirements is a threshold requirement that disqualifies taxpayers from consideration in other collection programs, such as installment agreements (IA) or offers in compromise (OIC).
2. When a taxpayer does not file a return, the IRS does not have the information to determine if his or her income is less than 250 percent of poverty level.<sup>41</sup>

First, equating the determination of economic hardship with compliance requirements for a collection alternative is not appropriate. When accepting an OIC or an IA, the IRS is agreeing to an alternative

34 SB/SE Finance, *Research and Strategy Project DEN0206 Federal Payment Levy Program (FPLP) and Low Income Taxpayers* (May 2013).

35 IRM 5.19.2.1, *What Is the Return Delinquency Program?* (Sept. 11, 2012).

36 IRS, Collection Activity Report, NO-5000-4, *Delinquent Return Activity Report* (Sept. 2014).

37 *Id.*

38 *Id.*

39 *Id.*

40 Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, TAD 2012-2, *Low Income Filter in the Federal Payment Levy Program* (Dec. 20, 2013).

41 *Id.*

payment arrangement, or settling the outstanding liability. In exchange, it is reasonable for the IRS to expect the taxpayer to abide by his or her current tax obligations. However, the purpose of including taxpayers in the LIF is to protect low income taxpayers from economic hardship and keep the IRS from issuing levies it would be required, by law, to release if challenged by the taxpayer (*i.e.*, when a taxpayer provides a financial statement showing economic hardship).

Second, the IRS argues filed returns are crucial to accurately determine if the taxpayer meets criteria for being filtered out of the FPLP (*i.e.*, did income fall below 250 percent of the federal poverty level). This argument is unconvincing in light of current IRS practices.

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Since the IRS generally has third-party information on taxpayers and already relies on such information in certain circumstances to construct returns, the IRS's claim that it cannot determine a taxpayer's income level without a filed return is unsound.

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For instance, when a taxpayer has not filed a return but has a filing requirement, the IRS uses third-party information to establish an Automated Substitute for Return (ASFR) to determine income and liability.<sup>42</sup> In fact, 96,156 taxpayers in FY 2014 were subject to a FPLP levy as a result of an ASFR assessment.<sup>43</sup> This illustrates that the IRS has no reservations about using the same data to establish ASFR assessments.<sup>44</sup> Moreover, there is nothing excluding liabilities associated with an ASFR from the FPLP, so these liabilities may be subject to the FPLP.<sup>45</sup> Furthermore, since ASFRs are closed as "return secured," and do not have a TDI indicator on the taxpayer's account, it appears these taxpayers could be processed through the LIF.<sup>46</sup> Since the IRS determined the income on the ASFR by considering third-party information, the IRS will ultimately be relying on third-party information when the account is being processed through the LIF. In other words, the IRS is excluding taxpayers from FPLP where it used third-party information to construct an ASFR return and the taxpayer's income falls below 250 percent of the federal poverty level. Therefore, since the IRS generally has third-party information on taxpayers and already relies on such information in certain circumstances to construct returns, the IRS's claim that it cannot determine a taxpayer's income level without a filed return is unsound.

### Recent Agreements and Ongoing Negotiations to Improve the LIF.

After the IRS sustained the appealed portions of TAD 2012-2, thereby rejecting the National Taxpayer Advocate's recommendation to eliminate the LIF's unfiled return exclusion criteria, it further analyzed the FPLP program and sent the National Taxpayer Advocate a memorandum stating: "Based on the analysis

42 IRM 5.18.1, *Automated Substitute for Return (ASFR) Program* (June 21, 2013). The ASFR program is the key compliance program that enforces filing compliance of taxpayers who have not filed individual tax returns, but owe a significant liability. ASFR determines and assesses the tax liability, relying on the same third-party information the IRS is reluctant to rely on in the context of the LIF.

43 Information Returns Master File and the Individual Master File and Accounts Receivable Dollar Inventory.

44 Pub. L. No. 110-289, 122 Stat. 2654 (2008). Section 3091 of the Housing and Economic Recovery Act of 2008 added § 6050W to the IRC which requires banks or organizations who make contractual payments to merchants in settlement of third-party payment card transactions (*i.e.*, transactions made by debit or credit card) to report such payments to the IRS. This reporting was designed to assist the IRS in matching income from sales to income reported on tax returns. See also IRM 21.7.4.4.24, Form 1099-K, *Payment Card and Third-Party Network Transactions—Reporting Requirements* (May 28, 2014). If third-party documentation is so unreliable, it is questionable why the IRS sought out legislative authority to develop a compliance program that solely relies on such documentation.

45 IRM 5.11.7.2.2.2, *Exclusions* (Aug. 12, 2011).

46 IRM 5.18.1.7.11.51, *Status 105: CLOSED, Post 90 Day Letter, Return Secured* (Sept. 5, 2013).

conducted to date, SB/SE has recommended a change that would apply the Low Income Filter (LIF) to taxpayers with one or more TDI indicator when the taxpayer is:

- Over 65 years of age,
- Has filed an income tax return for at least one of the last three tax years, and
- The IRS has not identified a potential delinquent return after the last filed return.<sup>47</sup>

After applying these three criteria to taxpayer accounts, only about ten percent of taxpayers who have income below 250 percent of the federal poverty guidelines and who have a TDI indicator on their account are included in the LIF.<sup>48</sup> The remaining 90 percent of low income taxpayers with a TDI indicator on their accounts are left unprotected and are subject to an FPLP levy.<sup>49</sup>

However, the Commissioner has recently agreed to a meaningful change to the FPLP program by excluding SSDI (Disability) recipients from the FPLP Program.<sup>50</sup> The decision was made in large part because of the particular demographics pertaining to SSDI recipients and the hardship an FPLP levy could cause. Specifically:

- The earnings limit for a taxpayer on disability is \$1,070 per month, or \$12,840 per year.<sup>51</sup>
- The median adjusted family income for someone on disability is \$13,323 per year. If the recipient is married, it is \$16,686 per year.
- The family income for 80 percent of people receiving SSA disability payments is not more than \$35,057 per year.<sup>52</sup>

In FY 2014, 79,277 out of 252,424 taxpayers with FPLP payments—or 31 percent—appeared to have disability income,<sup>53</sup> and 13,021 of the 79,277 taxpayers had income below 250 percent of the federal poverty level, but bypassed the LIF because they had a TDI indicator on their account.<sup>54</sup> On average, these taxpayers had about \$113 levied from their SSDI benefit each month.<sup>55</sup> Thus, about one-third of the taxpayers subjected to FPLP will be excluded from the program once the change is implemented. The National Taxpayer Advocate recognizes this as a significant change that will help tens of thousands of taxpayers each year, and encourages the IRS to work with all affected stakeholders to implement the change as quickly as possible.<sup>56</sup> Since the inception of FPLP in 2002, the IRS has been actively harming

47 Memorandum from John M. Dalrymple, IRS Deputy Commissioner, Services and Enforcement to Nina E. Olson, National Taxpayer Advocate, *Low Income Filter in the Federal Payment Levy Program* (Mar. 25, 2014).

48 IRS, *Federal Payment Levy Program: Augmentation Proposals for the Low Income Filter (LIF) for Taxpayers with TDI Modules* (Jan. 7, 2014).

49 *Id.*

50 On October 6, 2014, the IRS formally requested that BFS exclude SSDI recipients from the FPLP Program. See Memorandum from Darren John Guillot, Director, Enterprise Collection Strategy, to Wanda Rogers, Deputy Commissioner, Bureau of the Fiscal Service, *Discontinuation of Offset of Disability Portion of Old Age, Survivor and Payments Against Outstanding Federal Debt* (Oct. 6, 2014).

51 SSA, Publication No. 05-10003, ICN 451385 (Jan. 2014), available at <http://www.ssa.gov/pubs/EN-05-10003.pdf>.

52 SSA, Office of Research, Evaluation, and Statistics, *Income of Disabled-Worker Beneficiaries* (Released Jan. 2014), available at [http://www.socialsecurity.gov/policy/docs/chartbooks/income\\_workers/](http://www.socialsecurity.gov/policy/docs/chartbooks/income_workers/).

53 Information Returns Master File Form 1099-SSA/RRB and Individual Master File on the IRS Compliance Data Warehouse. This data was obtained by reviewing 1099s for tax year 2013.

54 Information Returns Master File and the Individual Master File.

55 These taxpayers paid nearly \$108 million of over \$413 million of FPLP payments in FY 2013 (or 26.0 percent).

56 IRS response to TAS information request (Sept. 29, 2014). To implement this programming change, the IRS will work with both the BFS and the SSA to determine how to identify the SSDI payments.

this vulnerable group of taxpayers via the program, and it should now move with all due speed to cease the harm.

## CONCLUSION

The National Taxpayer Advocate has consistently stated that the current LIF exclusion criteria fails to protect low income taxpayers and urged the IRS to eliminate the unfiled return exclusion. The IRS's refusal puts the IRS at odds with its own guidance and compromises taxpayers' *right to privacy* and the *right to a fair and just tax system*. The IRS's explanation for not eliminating this criterion is unjustified and its unwillingness to eliminate the unfiled return exclusion will only continue to harm low income taxpayers.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS should:

1. Eliminate the LIF exclusion for unfiled returns.
2. Expedite programming to exclude taxpayers receiving SSDI payments from the FPLP.
3. In collaboration with TAS, SB/SE should review the FPLP program requirements and ensure that the correct taxpayers are bypassing the LIF.

MSP  
#20**OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise****RESPONSIBLE OFFICIALS**

Karen Schiller, Commissioner, Small Business/Self-Employed Division  
Kirsten B. Wielobob, Chief, Office of Appeals

**DEFINITION OF PROBLEM**

An offer in compromise (OIC) is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount owed. The IRS has authority to accept offers pursuant to Internal Revenue Code (IRC) § 7122.<sup>1</sup> Treasury Regulations provide three grounds for an offer:

- A. Doubt as to liability;<sup>2</sup>
- B. Doubt as to collectability;<sup>3</sup> and
- C. Effective tax administration (ETA).<sup>4</sup>

Legislators have long viewed the OIC as a viable and reasonable collection alternative.<sup>5</sup> The IRS Restructuring and Reform Act of 1998 (RRA 98) introduced the Effective Tax Administration offer and provided specific guidance to the IRS on accepting such offers.<sup>6</sup> However, IRS policies and procedures do not foster flexible use of the OIC.<sup>7</sup>

In fiscal year (FY) 2014, the IRS received 66,155 offers and accepted 26,924.<sup>8</sup> The number of accepted offers decreased approximately 13 percent compared to FY 2013, when the IRS received 71,644 new offers and accepted 30,840 offers.<sup>9</sup> Meanwhile, the IRS continues to place billions of dollars' worth of accounts in its collection "Queue" and other inactive statuses.<sup>10</sup> As of September 30, 2014, the Queue held

1 See Treas. Reg. 301.7122-1(b)(1).

2 See *id.* Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax liability under the law. Doubt as to liability does not exist where the liability has been established by a final court decision or judgment concerning the existence or amount of the liability.

3 See Treas. Reg. 301.7122-1(b)(2). Doubt as to collectability exists in any case where the taxpayer's assets and income are less than the full amount of the liability.

4 See Treas. Reg. 301.7122-1(b)(3). There are two grounds for ETA offers: 1) If the Secretary determines that, although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship within the meaning of Treas. Reg. § 301.6343-1 and; 2) If there are no grounds for an offer under the other OIC criteria, the IRS may compromise to promote effective tax administration where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability. Compromise will be justified only where, due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.

5 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206 (1998); H.R. Conf. Rep. 599, 105th Cong., 2d Sess. 288-289 (1998).

6 H.R. Conf. Rep. No. 105-599 at 289 (1998).

7 See National Taxpayer Advocate 2012 Annual Report to Congress 354-355. See also Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure*, *infra*.

8 IRS, *OIC Executive Summary Report* (Sept. 2014). The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

9 *Id.* The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

10 Taxpayer Delinquent Accounts (TDAs), IRS NO-5000-2, *Taxpayer Delinquent Cumulative Report*, Part 1 (July 2014).

3,097,401 taxpayer delinquent account (TDA) modules valued at \$57.7 billion.<sup>11</sup> As of September 30, 2014, cases in “shelved” status totaled 1,777,346 TDAs with a value of \$8.3 billion.<sup>12</sup>

With the current system, the IRS is not only gradually losing the ability to collect any revenue on aging collection inventory, but is denying taxpayers a timely resolution of their tax problems, thereby violating the *right to finality*.<sup>13</sup> Additionally, when the IRS unreasonably denies an OIC and resumes collection activity, it may violate the taxpayer’s *right to privacy* which ensures that any IRS enforcement action be *no more intrusive than necessary* (emphasis added).<sup>14</sup> Lastly, the IRS approach to OICs may deny offers to eligible taxpayers by not considering all the facts and circumstances affecting an underlying liability, thereby undermining the *right to a fair and just tax system* and harming future compliance.<sup>15</sup>

## ANALYSIS OF PROBLEM

### Congress Envisioned a Flexible OIC Program that Could Improve Compliance.

The Senate intended that the IRS would adopt a “liberal acceptance policy for [offers] to provide an incentive for taxpayers to continue to file tax returns and continue to pay their taxes.”<sup>16</sup> This view was also adopted in the conference report for RRA 98:

The conferees believe that the IRS should be flexible in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer-in-compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.<sup>17</sup>

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- 11 Taxpayer Delinquent Accounts (TDAs), NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2014). For information on the Queue, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 39-70, (Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*).
- 12 Taxpayer Delinquent Accounts (TDAs), NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2014). “Shelved” cases are accounts that are not actively assigned, or are removed from active inventory due to their relatively low case assignment priority. See National Taxpayer Advocate 2013 Annual Report to Congress 124. See also Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2006-30-030, *High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, But Some Unassigned Accounts Need Management’s Attention* 16 (2006). Unlike “shelved” cases, the Queue holds cases until they can be assigned to Collection function employees. Cases in the Queue may end up being put in shelved status.
- 13 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>. The right to finality provides that “[t]axpayers have the right to know the maximum amount of time they have to challenge the IRS’s position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.” (emphasis added). The collection industry estimates that the probability of collecting unpaid accounts falls to 70 percent after three months, 52 percent after six months, and 23 percent after a year. See, e.g., TIGTA, Ref. No. 2011-30-112, *Reducing the Processing Time Between Balance Due Notices Could Increase Collections* 8 (2011) (citing collectability statistics based on a survey conducted by the Commercial Collection Agency Association).
- 14 In the collection arena, the right to privacy becomes meaningful and significant through Collection Due Process (CDP). IRC §§ 6320, 6330. Congress created CDP rights to provide extra measures of protection for taxpayers against abuse in the collection arena and included the balancing test among the three major elements of a CDP hearing to ensure that any collection action be “no more intrusive than necessary.” IRC § 6330(c)(3)(C). See also H.R. REP. NO. 105-599, at 263 (1998) (Conf. Rep.); S. REP. NO. 105-174, at 68 (1998).
- 15 TAS research has shown that factors related to trust in government and fairness appear to have significant influence on the taxpayer compliance behavior of self-employed taxpayers. National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*).
- 16 S. REP. NO. 105-174 at 88 (1998).
- 17 RRA 98, Pub. L. No. 105-206 (1998); H.R. REP. NO. 105-599, at 288-89 (1998) (Conf. Rep.).

In particular, Congress provided direct guidance to the IRS in its desire to see the implementation of ETA offers with RRA 98:

...[T]he conferees anticipate that the IRS will take into account factors such as equity, hardship, and public policy where a compromise of an individual taxpayer's income tax liability would promote effective tax administration. The conferees anticipate that ... the IRS may utilize this new authority to resolve longstanding cases by forgoing penalties and interest which have accumulated as a result of delay in determining the taxpayer's liability.<sup>18</sup>

### The OIC Program Benefits Taxpayers and the IRS Alike by Improving Compliance and Bringing Finality to Accounts.

With a flexible offer program, the IRS wins by receiving money that it could not have collected through other means and achieving a promise of voluntary tax compliance from the taxpayer (at least for the next five years, which is long enough to create long-term change in noncompliant behavior).<sup>19</sup> If the taxpayer does not follow the terms of the agreement, the OIC defaults and the debt is reinstated.<sup>20</sup> Offers accepted in FY 2013 have a 2013 compliance rate of 95.2 percent while the 2013 compliance rate for offers accepted in FY 2009 is 88.1 percent.<sup>21</sup> The FY 2009 rate, which is the compliance rate after five years, is significantly higher than the comparable voluntary compliance rate for tax year (TY) 2009 for the individual taxpayers with tax delinquent accounts, which is 42 percent.<sup>22</sup> For the taxpayer who has been noncompliant in the past, an accepted offer may become a fresh start. For the IRS, the OIC converts a noncompliant taxpayer into a compliant one. Overall, a flexible OIC program promotes effective and just tax administration.<sup>23</sup>

Other IRS collection practices cannot claim the same positive outcomes. In 2011, TAS research showed that taxpayers with liens filed against them are less likely to reduce their initial liabilities and file required tax returns.<sup>24</sup> A 2012 TAS research study found 80 percent of taxpayers in currently not collectible (CNC) hardship status who also had offers had no tax liability at the end of the study, compared to about 20 percent of CNC hardship taxpayers without offers.<sup>25</sup>

18 H.R. REP. No. 105-599, at 289 (1998) (Conf. Rep.).

19 IRS, Form 656-B, *Offer In Compromise* 5 (Jan. 2014).

20 See Internal Revenue Manual (IRM) 5.8.9.3, *Potential Default Cases*, (April 15, 2011); IRS, Form 656-B, *Offer In Compromise* (Jan. 2014).

21 IRS response to fact check (Nov. 26, 2014). The compliance rate is computed as  $\{1 - (\text{default OICs} / \text{accepted OICs})\}$ .

22 TAS computed compliance rates with the following formula:  $(1 - \text{noncompliance rate})$ . The noncompliance rate for tax years for individual taxpayers with delinquent tax accounts was computed by identifying those who had any tax delinquent accounts or delinquent tax investigations for subsequent tax years and dividing it by individual taxpayers with delinquent tax accounts for that year. Individual Taxpayers with TDAs Compliance rates, TAS Research (2014-12), Compliance rate for TY 2009 is  $[1 - \{(1,878,396 \text{ taxpayers with TDAs or TDIs}) / (3,255,566 \text{ taxpayers with TDAs})\}]$ , which equals 42.3 percent.

23 One attorney who testified before Congress regarding RRA 98 called the IRS's handling of offers "the biggest scandal in American taxation today." The attorney observed, "The IRS is willing to force an otherwise productive taxpayer into bankruptcy rather than to accept a fair offer in compromise." *IRS Restructuring, Hearings Before the S. Comm. on Finance*, 105th Cong. 129 (1998) (statement of Robert Schriebman, Tax Attorney).

24 See National Taxpayer Advocate 2011 Annual Report to Congress, vol 2 94. However, lien filing may have a positive effect on future payment. The study points out that it is unclear if the lien filing improved future payment or if lien filing merely reduces the likelihood that a taxpayer will report a subsequent liability. See National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 91-112 (Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

25 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 123.

However, to be effective the OIC program must analyze the facts and circumstances particular to each taxpayer submitting an offer. A study commissioned by the IRS found that lack of flexibility and consistency in evaluating the overall financial situation of the taxpayer was a recurring perception among study participants.<sup>26</sup>

### In Practice, Many Taxpayers Experience Significant Hardship Due to Underuse of the OIC Program.

In FY 2014, the IRS received 66,155 new offers and accepted 26,924.<sup>27</sup> Accepted offers declined by approximately 13 percent from the same period in FY 2013, when the IRS received 71,644 new offer cases and accepted 30,840 OICs.<sup>28</sup> Figure 1.20.1 shows received and accepted OICs since FY 2010.<sup>29</sup>

**FIGURE 1.20.1, OIC receipts, acceptances, and receipts by taxpayer type**<sup>30,31,32,33</sup>

Fiscal year	Receipts	Receipts less transfers to Appeals	IMF and BMF taxpayers receipts	Acceptances
2010	56,539	n/a	52,211	13,886
2011	59,411	n/a	54,786	19,562
2012	63,801	n/a	59,515	23,628
2013	74,217	71,644	69,385	30,840
2014	69,735	66,155	61,882	26,924

Meanwhile, the number of taxpayers in CNC hardship status has risen from 2.5 million to 2.8 million, or 11 percent, between September 2007 and September 2014.<sup>34</sup> The CNC inventory now holds \$82.5 billion in inventory, a 70 percent increase from September 2007.<sup>35</sup>

26 MITRE Corporation, *Offer in Compromise Study: Achieving Increased Offer in Compromise (OIC) Program Participation Requires New Approaches* (Jan. 29, 2010). The IRS engaged the MITRE Corporation to study the OIC application process and “provide an independent perspective on the decline in OIC applications.” As one part of the study, MITRE interviewed more than 40 internal and external stakeholders.

27 IRS, *OIC Executive Summary Report* (Sept. 2014). The amount reported is the net receipt of OICs on a national level, which is defined as the amount of national new receipts plus the amount of national doubt as to liability receipts.

28 *Id.*

29 IRS response to TAS research request (July 31, 2014). The number of receipts includes processable receipts. Accepted offers are based on year of receipt.

30 IRS, *OIC Executive Summary Report*, (Sept. 2010–2014), Receipts (New Cases).

31 *Id.* Receipts Less Transfers to Appeals (Net Receipts). IRS began reporting in FY 2013.

32 IRS response to fact check (Nov. 26, 2014), IMF and BMF taxpayers’ receipts.

33 IRS, *OIC Executive Summary Report*, (Sept. 2010 - 2014), Accepts.

34 IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2007); IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (June 2014). The 2,515,349 CNC hardship taxpayers increased to 2,794,869 taxpayers from September 2007 to September 2014.

35 *Id.* The CNC inventory went from \$48,690,826,891 in September 2007 to \$82,538,709,904 in September 2014.

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**With a flexible offer program, the IRS wins by receiving money that it could not have collected through other means and achieving a promise of voluntary tax compliance from the taxpayer (at least for the next five years, which is long enough to create long-term change in noncompliant behavior).**

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When the IRS determines that a taxpayer cannot afford to pay his or her debt but chooses CNC over an offer as the suitable solution, it denies a prompt resolution for both the taxpayer and the IRS. The IRS can consider offers for low income taxpayers because employees are instructed to not reject an offer solely based on the amount.<sup>36</sup> In fact, one 2010 study estimated that \$8.5 million in additional revenue could be obtained by targeting taxpayers facing economic hardship.<sup>37</sup> However, several factors are preventing a flexible use of offers.

### *Lack of Appropriate Staffing Precludes a Thorough Review of Submitted Offers.*

Since 2000, the OIC program and OIC-related issues have appeared consistently as a Most Serious Problem in the National Taxpayer Advocate's Annual Report to Congress.<sup>38</sup> One area of concern is the inadequate staffing for the OIC program.<sup>39</sup> In fact, OIC receipts increased steadily from FY 2010 to FY 2013, with a decrease of about 11 percent in FY 2014.<sup>40</sup> Total OIC staffing has remained virtually constant since 2007 and is approximately half of what it was in 2004, as shown in Fig 1.20.2.

36 See IRC § 7122(d)(3)(A). The National Taxpayer Advocate, who at the time was executive director of the Community Tax Law Project in Richmond, Virginia, testified that "There should be no minimum amount for an offer and compromise based as to doubt as to collectability... Any other policy allows certain taxpayers to buy piece of mind while others cannot." *IRS Restructuring, Hearings Before the S. Comm. on Finance, 105th 125 Cong. (1998)* (statement of Nina E. Olson, Executive Director, Community Tax Law Project).

37 This measurement is an estimate based on 5 percent of 300,000 taxpayers in CNC status. See IRS, *IRS Collection Process Study, Final Report 141-142* (Sept. 30, 2010).

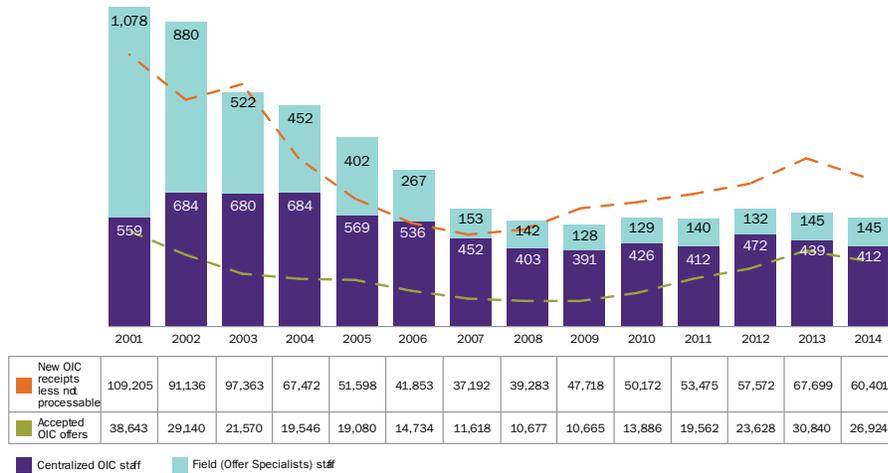
38 See National Taxpayer Advocate 2000-2013 Annual Reports to Congress.

39 TIGTA, Ref. No. 2012-30-033, *Increasing Requests for Offers in Compromise Have Created Inventory Backlogs and Delayed Responses to Taxpayers* (Mar. 30, 2012).

40 IRS Collection Report NO-5000-108, Monthly Report of OIC Activity, Cumulative Through September, 2008-2014. Processable OIC receipts increased an average of 10.5 percent from FY 2008 to FY 2013. The change in processable receipts for FY 2014 from FY 2013 was -10.8 percent.

FIG. 1.20.2<sup>41</sup>

OIC staffing and OIC processable receipts and acceptances, FYs 2001-2014



The Treasury Inspector General for Tax Administration (TIGTA) recently recommended that in light of the growth in delinquent accounts and the reduction in IRS staffing, it is “essential that the field inventory selection process identifies the cases that have the highest risk and potential for collection.”<sup>42</sup> TIGTA also reported that because the probability that revenue will be collected is not “fully considered” when cases are selected for inventory, a large number of cases are assigned to field collection that involve taxpayers who have no ability to pay or cannot be found.<sup>43</sup> Since the revenue officers working these cases are already conducting the financial analysis to determine CNC status, a flexible approach to OIC consideration prior to putting a case in CNC status could further Congress’s intent and protect taxpayer rights.

*Reliance on the Queue Discourages Use of the OIC.*

The Queue is where the IRS holds aging accounts until they are paid, written off, or pulled for assignment to the Collection Field function (Cff). In theory, the assignment of a case to the Queue is a temporary condition; cases reside in the Queue until the Cff has resources to work them.<sup>44</sup> In practice, the Queue is not “temporary;” rather, the backlog has become an institutionalized segment of the IRS

41 Staffing counts are as of the beginning of the fiscal year, except for the staffing count in 2014, which is as of June 2014. IRS response to TAS research request (July 31, 2014). There is another group of Field OIC staff that the IRS started tracking in 2013. We have limited the discussion to field offer specialists and centralized OIC staff since there is no earlier history on the third group. We are unable to say how the change has occurred over time, since the IRS was not tracking them as it had with the field offer specialists and centralized OIC staff. Also, prior to August 2001, all offers regardless of complexity were handled in the field by revenue officers. In that month, the IRS commenced a new approach to processing offers, the Centralized OIC (COIC) initiative. The initial processing of all offers, and complete processing of wage earner offers is now handled in two campus locations. As a result, the number of revenue officers working offers is sharply reduced as of 2002. See National Taxpayer Advocate 2002 Annual Report to Congress 15.

42 TIGTA, Ref. No. 2014-30-068, *Field Collection Could Work Cases With Better Collection Potential* 4 (Sept. 12, 2014).

43 *Id.* at 5-7 (Sept. 12, 2014). The report shows that 40 percent of TDAs closed by field collection are determined to be CNC.

44 For more information on the Queue, see National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, 39-70 Research Study: *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*.

collection process.<sup>45</sup> The Queue’s inventory has increased 26 percent since 2006; as of September 30, 2014, the Queue held 3,097,401 TDA modules, valued at \$57.7 billion.<sup>46</sup>

Recently, the IRS has also been placing Automated Collection System (ACS) cases in a “shelved” status, closed as CNC, as another means of moving cases from active collection status.<sup>47</sup> The cases in this status have risen from 1.5 million TDAs in September 2007 to 1.8 million in September 2014, an increase of roughly one fifth.<sup>48</sup> However, the dollar amount in inventory has jumped from \$3.6 billion in September 2007 to \$8.3 billion in September 2014, an increase of 130 percent.<sup>49</sup> This is a large increase in potentially lost revenue.

Figure 1.20.3, below, shows the growth of inventories in the Queue and shelved status between FYs 2003 and 2014. In particular, the Queue experienced growth between 2005 and 2009, and then declined in FY 2010, followed by increases in fiscal years 2011 and 2012. The Queue decreased in FY 2013, and was flat in FY 2014. The cases in shelved status increased from FY 2008 to FY 2011, but have been in a decline since.

FIGURE 1.20.3<sup>50</sup>

Queue inventory and shelved (surveyed TDAs), modules, FYs 2003-2014



45 The National Taxpayer Advocate concluded in 2012 that the “use of the Queue appears to have heavily contributed to the indifference of the IRS to the aging of collection accounts, and to the negative outcomes that the delays in case processing have for taxpayers and the IRS’s business results.” See National Taxpayer Advocate 2012 Annual Report to Congress 370.

46 IRS, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Oct. 2006); IRS, NO-5000-2, *Taxpayer Delinquent Accounts Report* (Sept. 2014). Queue inventory went from 2,453,556 cases in September 2006 to 3,097,401 cases in September 2014.

47 For information on shelved status, see National Taxpayer Advocate 2013 Annual Report to Congress 124. See also TIGTA, Reference No. 2006-30-030, *High-Risk Work Is Selected From the Unassigned Delinquent Account Inventory, But Some Unassigned Accounts Need Management’s Attention* 16 (Feb. 2006).

48 IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2007); IRS, NO-5000-149, *Recap of Accounts Currently Not Collectible Report* (Sept. 2014).

49 *Id.* The dollar amount in TDA inventory went from \$3,632,927,063 in September 2007 to \$8,342,735,676 by September 2014.

50 IRS, Queue Inventory: Collection Report No. 5000-2, *Taxpayer Delinquent Account Cumulative Report, Part 1 - TDA’S* (2003-2014) and IRS, Shelved (Surveyed TDAs): IRS Collection Report No. 5000-149, *Recap of Accounts Currently Not Collectible Report* (2003-2014).

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The number of accepted offers decreased approximately 13 percent compared to fiscal year 2013, when the IRS received 71,644 new offers and accepted 30,840 offers. Meanwhile, the IRS continues to place billions of dollars' worth of accounts in its collection "Queue" and other inactive statuses.

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The primary reason for rejected and returned offers since 2010 has been the IRS's determination that the taxpayer can pay in full.<sup>51</sup> However, a 2004 IRS study showed that reliance on this determination can lead to the IRS rejecting an offer and then ultimately not collecting anything from the taxpayer.<sup>52</sup> The study found that in 31 percent of the rejected OIC cases reviewed, the IRS collected less than 10 percent of the offered amounts and in 21 percent the IRS collected nothing at all.<sup>53</sup> Similar to our measurements today, this study reported that "in most situations the decision to reject an OIC was based on a determination by the IRS that it could collect more than the offer amount."<sup>54</sup> Yet the 2004 study shows that in a significant number of cases, the IRS did *not* collect more revenue and walked away from dollars that were actually offered.<sup>55</sup> The study also found that of the rejected or withdrawn offers in CNC status, 27 percent of individual offers and 49 percent of business offers were in CNC status while the offer was being considered.<sup>56</sup> Since the taxpayer was not collectible, it is likely the taxpayer was offering funds that were supplied by someone who has no liability for the tax debt, *e.g.*, a parent, a friend, or a church or charity. By rejecting or requiring withdrawal of the offer, the IRS turned down funds that it could not otherwise reach. These 2004 observations are relevant today, given the growth in CNC inventory.

### *The IRS Discourages a Flexible Use of the ETA Offer.*

The ETA offer allows the IRS to consider the circumstances that led to a delinquency and weigh the long-term benefits of allowing an otherwise viable taxpayer to become compliant.<sup>57</sup> ETA offers are allowed even if the IRS could achieve full collection when that full collection would create an economic hardship for

51 IRS response to TAS research request (July 31, 2014). The IRS relies on IRM 5.8.4.3 when determining if a taxpayer can full pay. IRM 5.8.4.3, *Doubt as to Collectibility*, (May 10, 2013).

52 In FY 2003, SB/SE and the Office of Program Evaluation and Risk Analysis (OPERA) analyzed the OIC program to study, among other things, the ultimate collection outcomes of offers that had been closed as either rejected, withdrawn, or returned. OPERA, *IRS Offers in Compromise Program, Analysis of Various Aspects of the OIC Program 2-6* (Sept. 2004). The study highlighted the fact that the value of an accepted offer is more than the actual money generated from the offer but that "potentially lost revenue can be 'protected' by correcting the delinquent behavior, and getting these taxpayers on the right taxpaying track."

53 *Id.* at 11. The study involved analysis of every closed OIC during the period of October 1998 through July 2003. See also National Taxpayer Advocate 2006 Annual Report to Congress 106.

54 *Id.* at 8.

55 *Id.* at 9. The study reported that offers accepted between 1995 and 2001 had a 60 percent compliance rate, and this could go to 80 percent when taxpayers with first collection notices are excluded. This compliance rate is much higher than the 39 percent compliance rate for rejected cases that either full paid or entered into an installment agreement. Acceptance of these rejected offers could have generated greater compliance and payments received.

56 OPERA, *IRS Offers in Compromise Program, Analysis of Various Aspects of the OIC Program 9* (Sept. 2004).

57 For information on how the low ETA offer acceptance rate affects business taxpayers in particular, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply With the Law Regarding Victims of Payroll Service Provider Failure*, *infra*; National Taxpayer Advocate 2013 Annual Report to Congress 134-146 (Most Serious Problem: *COLLECTION PROCESS: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue*); National Taxpayer Advocate 2012 Annual Report to Congress 348-357 (Introduction: *The IRS "Fresh Start" Initiative Has Produced Significant Improvements in Some Collection Policies; However, Significantly More Emphasis on Service Delivery Is Necessary to Realize the Full Benefits of These Important Changes*). See also National Taxpayer Advocate 2012 Annual Report to Congress 426-444 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

the taxpayer.<sup>58</sup> The IRS also accepts ETA offers when the taxpayer identifies “compelling public policy or equity considerations.”<sup>59</sup>

In light of the growth in the Queue, shelving, and CNC, we should see more ETA offers being accepted. The acceptance rate rose from 40 percent in 2010 to 52.9 percent in 2014.<sup>60</sup> The acceptance rate of non-economic hardship (NEH) ETA offers increased from 31.4 percent in FY 2010 to 58.4 percent in FY 2014.<sup>61</sup> Figure 1.20.4 shows the ETA and NEH ETA offers received and accepted by the IRS between FYs 2010 and 2014.<sup>62</sup>

**FIGURE 1.20.4, ETA and NEH ETA offers received and accepted<sup>63</sup>**

Fiscal year	ETA Offers			NEH-ETA Offers			
	Receipts	Dispositions	Accepted	Receipts	Dispositions	Accepted	Accepted other than NEH
2010	1,457	1,136	460	61	51	16	5
2011	1,553	1,479	602	76	89	27	3
2012	2,086	1,841	826	56	67	21	7
2013	2,336	2,352	1,147	77	59	26	4
2014	1,486	2,019	1,069	100	89	52	7

The regulations require the taxpayer submitting an ETA offer on public policy grounds to “demonstrate circumstances that justify compromise even though a similarly situated taxpayer may have paid his liability in full.”<sup>64</sup> Based on this guidance, the IRS has implemented procedures that may discourage the acceptance of ETA offers. For instance, the IRS acknowledges that when considering an ETA offer on public policy or equity grounds, “the compromise ... will often raise the issue of disparate treatment of taxpayers who can pay in full and whose liabilities arose under substantially similar circumstances.”<sup>65</sup> A taxpayer seeking an OIC under this category bears the burden of demonstrating “circumstances that are compelling enough to justify compromise notwithstanding this inherent inequity.”<sup>66</sup>

58 See Treas. Reg. § 301.7122-1(b)(3)(i).

59 See Treas. Reg. § 301.7122-1(b)(3)(ii).

60 IRS response to fact check (Nov. 26, 2014). Acceptance rate is computed as accepted ETA offers divided by ETA dispositions.

61 *Id.* Acceptance rate is computed as accepted NEH-ETA offers divided by NEH-ETA dispositions.

62 IRS response to TAS research request (July 31, 2014). Offers submitted under NEH-ETA may also be accepted under doubt as to collectability criteria.

63 IRS response to TAS fact check (Nov. 26, 2014).

64 Treas. Reg. § 301.7122-1(b)(3)(ii).

65 IRM 5.8.11.2.2(3), *Public Policy or Equity Grounds*, (Sept. 23, 2008).

66 *Id.*

In cases involving non-hardship ETA offers, “[t]he circumstances of the case must be such that other taxpayers would view the compromise as a fair and equitable result.”<sup>67</sup> The IRM goes on to say that “it should not appear to other taxpayers that the result of the compromise places the taxpayer in a better position than they would occupy had they timely and fully met their obligations” (emphasis added).<sup>68</sup> This language does not appear in the regulations. Under the regulations, ETA offers based on public policy or equity may not be entered into if compromise of the liability “would undermine compliance by taxpayers with the tax laws.”<sup>69</sup> Factors that could support a determination that compromise would undermine compliance include:

- The taxpayer has a history of noncompliance with filing and payment requirements;
- The taxpayer has taken deliberate actions to avoid the payment of taxes; and
- The taxpayer has encouraged others to refuse to comply with the tax laws.<sup>70</sup>

While achieving a “fair and equitable result” per the IRM is a commendable goal, the IRS’s requirement that the OIC should not be perceived by other taxpayers as placing the noncompliant taxpayer in a better position goes beyond the requirements in the regulations. It may lead to subjective determinations by IRS employees who are not in position to assume the perceptions of other taxpayers.<sup>71</sup> If the IRS persists in requiring this subjective assessment, it should revise its procedures to have the National Taxpayer Advocate, as the voice of taxpayers within the IRS, determine whether other taxpayers would view the compromise as fair and equitable.

ETA offers submitted by businesses are specifically treated with caution to avoid “providing financial advantages through the forgiveness of tax debt.”<sup>72</sup> As a result, the IRS has adopted an inflexible approach that “generally” requires an OIC submitted by an operating business provide for payment of the full amount of tax, exclusive of interest and penalties.<sup>73</sup> This is an illogical distinction to draw for offers submitted by businesses,<sup>74</sup> as individual taxpayers can also benefit from the acceptance of offers. For instance, if an individual satisfies a liability through an offer, the person may then be able to take vacations or buy cars whereas a taxpayer who has a debt and does not submit an offer or who has consistently paid all of his or her taxes may be struggling.

67 IRM 5.8.11.2.2(3), *Public Policy or Equity Grounds*, (Sept. 23, 2008).

68 *Id.* The taxpayer must also have remained in compliance since incurring the liability and overall their compliance history should not weigh against compromise. The taxpayer must have acted reasonably and responsibly in the situation giving rise to the liabilities.

69 Treas. Reg. § 301.7122-1(b)(3)(iii).

70 Treas. Reg. § 301.7122-1(c)(3)(ii). While the regulations point out that this list is not exhaustive, there is no mention of other taxpayers as a factor.

71 NEH ETA OIC denials based on IRS employees’ subjective determinations of other taxpayers’ potential perceptions may be viewed as arbitrary and capricious, and as such, may violate a taxpayer’s *right to a fair and just tax system*. For taxpayers who cannot access the OIC as a collection alternative, these procedures can undermine the *right to finality*.

72 IRM 5.8.11.4.3(2), *Determining an Acceptable Offer Amount*, (Sept. 23, 2008). For information on how this impacts businesses that have been victimized by fraudulent payroll service providers, see Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply With the Law Regarding Victims of Payroll Service Provider Failure*, *infra*.

73 IRM 5.8.11.4.3 (Sept. 23, 2008).

74 See National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 19-25; National Taxpayer Advocate 2013 Annual Report to Congress 134-146 (Most Serious Problem: *COLLECTION PROCESS: IRS Collection Procedures Harm Business Taxpayers and Contribute to Substantial Amounts of Lost Revenue*); National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 33-56 (Research Study: *Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2011 Annual Report to Congress (Legislative Recommendation: *Amend IRC § 6343(a) to Permit the IRS to Release Levies on Business Taxpayers that Impose Economic Hardship*). In the context of trust fund recovery penalty, one court noted that the financially struggling business should be allowed “minimum working capital ... to maintain operations and avoid liquidation of the business.” See *In re Rossiter*, 167 B.R. 919 (C.D. Cal. 1994).

These procedures implicate the *right to a fair and just tax system*, which is officially described as the “right to expect the tax system to consider facts and circumstances that might affect [the taxpayer’s] underlying liabilities [and] ability to pay.”<sup>75</sup> Under the current IRS approach, taxpayers’ circumstances are not the focus of the analysis—rather it is some subjective perception on the part of the IRS about competitive “advantage.” These procedures also go against the clear congressional intent of a flexible OIC program.

### The Underutilization of the OIC Program Undermines Taxpayers’ Rights.

Proper and flexible use of OICs is important for taxpayer rights such as *the right to be informed*, *the right to quality service*, *the right to finality*, and *the right to a fair and just tax system*.<sup>76</sup> Without access to OICs, many taxpayers lose an opportunity to settle their debt in a definitive way, as envisioned by Congress in RRA 98. Business taxpayers may be unable to resolve liabilities and may be forced to cease operations.<sup>77</sup> The *right to a fair and just tax system* means the IRS should consider the facts and circumstances of each taxpayer during the offer process. Thus, proper and timely consideration of OICs would promote taxpayer rights and result in improved compliance.

## CONCLUSION

Congress intended for a flexible use of the OIC program. By not taking a flexible approach to OICs, the IRS is missing opportunities to improve compliance, collect revenue, and support the nation’s economy, including the following:

- The IRS is not following Congress’s mandate to effectively use the OIC as a viable compliance tool for all taxpayers;
- The IRS has greatly underutilized the ETA offer for all taxpayers, but Business Master File taxpayers in particular; and
- The IRS could enhance collection revenue using the OIC as an alternative to CNC status, shelved status, and the Queue.

<sup>75</sup> IRS, Publication 1, *Your Rights as a Taxpayer* (June 2014).

<sup>76</sup> See National Taxpayer Advocate 2013 Annual Report to Congress 5-19 (Most Serious Problem: *TAXPAYER RIGHTS: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*). To its credit, the IRS on June 10, 2014, adopted the Taxpayer Bill of Rights (TBOR) that the National Taxpayer Advocate has long recommended, pulling together in one basic statement the substantive rights scattered throughout the Internal Revenue Code.

<sup>77</sup> For instance, when a payroll service provider goes out of business for misappropriating its clients’ funds, the employers remain liable for the unpaid payroll tax, interest, and penalties that they have already paid. See National Taxpayer Advocate 2012 Annual Report to Congress 426-444 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*).

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Increase staffing in the OIC program to 2001 levels and train employees to evaluate complex offers. Staffing available to work offers can be increased by allowing all Revenue Officers to review and accept OICs as part of working their inventory.
2. Expand use of the Effective Tax Administration offer for both individual and business taxpayers with an emphasis on flexibility in evaluation of the taxpayer's circumstances.
3. Proactively identify cases that would be viable candidates for offers and reach out to those taxpayers prior to placing accounts in currently not collectible status, the Queue, or shelved status.
4. Increase the information and training about the OIC program provided to the Automated Collection System so employees can identify good offer candidates; and share more information with the Stakeholder Partnerships, Education and Communication unit, the Low Income Taxpayer Clinics, and the Volunteer Income Tax Assistance program.
5. Revise IRM 5.8.11.2.2(4) to remove the economic competition argument as it is irrelevant and violates the taxpayer's *right to a fair and just tax system*.
6. In the case of non-economic hardship ETA offers, if the IRS persists in requiring the subjective assessment of whether other taxpayers would view the compromise as a fair and equitable result, it should revise its procedures to have the National Taxpayer Advocate, as the voice of taxpayers within the IRS, determine whether other taxpayers would view the compromise as fair and equitable.

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#21**OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure****RESPONSIBLE OFFICIAL**

Karen Schiller, Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

Outsourcing payroll and related tax duties to third-party payroll service providers (PSPs) is a common business practice, especially for small business owners. PSPs can help employers meet filing deadlines and deposit requirements by withholding, reporting, and depositing employment taxes with state and federal authorities on behalf of the employer. If a PSP mismanages or embezzles funds that should have been paid to the IRS or state tax agency, the client employer remains responsible for unpaid tax, interest, and penalties. PSP incompetence or fraud often results in significant hardship for the business, which (from its perspective) must pay the tax twice—once to the failed PSP, and again to the IRS.

For the past decade, the National Taxpayer Advocate has recommended numerous administrative and legislative actions to assist victims of PSP failure.<sup>1</sup> Congress recently enacted legislation that incorporates two of these recommendations. The Consolidated Appropriations Act of 2014 requires the IRS to:

1. Issue dual address change notices related to an employer making employment tax payments (with one notice sent to both the employer's former and new address); and
2. Give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer.<sup>2</sup>

Notwithstanding significant improvements to the IRS's approach to these taxpayers, the National Taxpayer Advocate has the following concerns with the IRS response to this congressional mandate:

- While the IRS has stated its intention to start issuing dual address change notices by January 2015, it is unclear whether the IRS will meet this commitment.
- The IRS has not embraced its effective tax administration (ETA) OIC authority as a viable collection alternative and has consistently underutilized this tool to provide relief to victims.
- The proposed interim guidance on offers is inadequate.

1 See National Taxpayer Advocate 2012 Annual Report to Congress 426-44 (Most Serious Problem: *Early Intervention, Offers in Compromise, and Proactive Outreach Can Help Victims of Failed Payroll Service Providers and Increase Employment Tax Compliance*); National Taxpayer Advocate 2012 Annual Report to Congress 553-59 (Legislative Recommendation: *Protect Taxpayers and the Public Fisc from Third-Party Misappropriation of Payroll Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 337-54 (Most Serious Problem: *Third Party Payers*); National Taxpayer Advocate 2007 Annual Report to Congress 538-44 (Legislative Recommendation: *Taxpayer Protection From Third Party Payer Failures*); National Taxpayer Advocate 2004 Annual Report to Congress 394-99 (Legislative Recommendation: *Protection from Payroll Service Provider Misappropriation*).

2 Consolidated Appropriations Act, Pub. L. No. 113-76, Division E, Title I, § 106 (2014).

## ANALYSIS OF PROBLEM

### Dual Address Change Notices Can Alert Employers of Potential PSP Fraud.

Unscrupulous PSPs may wish to change their clients' addresses of record with the IRS without their clients' knowledge, which could keep an employer from learning it has delinquent tax deposits for months or even years. To prevent such an occurrence, the National Taxpayer Advocate recommended in her 2012 Annual Report to Congress that the IRS promptly issue dual address change notices to alert employers when a PSP initiates a change.<sup>3</sup> The address change notice would be sent to the taxpayer's new and old address, giving the employer an opportunity to contact the IRS if it did not initiate the change of address. That way, the employer will receive IRS correspondence about any penalties and interest that result from the PSP failing to make timely payments.

The IRS website recommends that the employer not change its address of record to that of the PSP.<sup>4</sup> However, the IRS has not yet adopted the National Taxpayer Advocate's recommendation to issue dual notices, despite the mandate from Congress to do so. As noted above, the Consolidated Appropriations Act of 2014 *requires* the IRS to issue a notice of confirmation of any address change relating to an employer making employment tax payments, and send such notice to both the employer's former and new addresses.<sup>5</sup>

On May 8, 2014, the IRS Commissioner sent a letter to the House and Senate appropriations committees, which stated that "dual notice language has been drafted and a programming change has been submitted" to allow notices to go to the old and new addresses, to be implemented by January 2015.<sup>6</sup> While the National Taxpayer Advocate commends the IRS for its initial steps to respond to this mandate, she will monitor the process to ensure that the IRS is on track to issue dual notices by the date promised.

### The IRS Should Embrace Its Authority to Compromise the Tax Liability of Victims of PSP Failure, Based on Effective Tax Administration.

Employers remain liable for unpaid payroll taxes when a PSP diverts employers' funds without paying the IRS the taxes due. When this occurs, employers may suffer a severe financial toll. Though they have complied with the tax laws by paying withholding and payroll taxes to their PSPs, these employers will be required, through no fault of their own, to pay the taxes a second time, along with interest and penalties. Some small businesses may be unable to recover from such a setback and be forced to shut down and lay off employees.

3 National Taxpayer Advocate 2012 Annual Report to Congress 444 ("establish ascertainable timeframes for beginning the use of dual address change letters alerting employers that a PSP has initiated a change of address, including email or text message notifications to taxpayers who so consent in a special field on employment tax returns"). See also National Taxpayer Advocate 2007 Annual Report to Congress 341 ("establish a procedure to send duplicate notices to the employer and the third party payer" and "notify affected employers when it becomes aware of a defunct third party payer").

4 See IRS, *Outsourcing Payroll Duties*, available at <http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Outsourcing-Payroll-Duties> (last visited Nov. 18, 2014).

5 Consolidated Appropriations Act, Pub. L. No. 113-76, Division E, Title I, § 106 (2014).

6 Letter from John A. Koskinen, IRS Commissioner, to U.S. Senate and House Committees on Appropriations (May 8, 2014). See also IRS, Unified Work Request 99807 (Dec. 30, 2013) (setting scheduled implementation for January 23, 2015). On January 2, 2015, the IRS issued SERP Alert 15A0001, *Dual Notices of Address Change*, stating that: "Beginning Jan. 23, 2015, when an address change occurs on an EIN reflecting Employment Tax FRCs (Form 94X series), a CP 148A will generate to the taxpayer's new address and a CP 148B will generate to the taxpayer's previous address."

In March 2013, the press widely reported that AccuPay, a Maryland-based payroll service provider, failed to remit taxes it collected from 500 to 600 clients.<sup>7</sup> AccuPay filed for Chapter 7 federal bankruptcy protection after clients claimed in lawsuits that some \$465,000 entrusted with AccuPay was not remitted to tax authorities.<sup>8</sup> TAS worked to alert former AccuPay clients of potential IRS collection action, and how to deal with the IRS regarding unpaid payroll taxes and unfiled returns.

TAS also coordinated with the IRS to forestall collection activity on the accounts of the affected clients while TAS works with the taxpayers to resolve their individual issues. The IRS designated a specific Criminal Investigations agent to deal with inquiries from victims of AccuPay.<sup>9</sup> In many cases, TAS successfully advocated to abate penalties for failing to timely deposit payroll taxes and accept installment agreements to pay the tax liability over time. However, TAS has been less successful in working with the IRS to compromise the underlying tax liability.

### *Authority to Accept Offers in Compromise Based upon Effective Tax Administration*

Under the Taxpayer Bill of Rights (TBOR), taxpayers have the *right to a fair and just tax system*. That is, taxpayers have the right to expect the system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. In recognition of this important taxpayer right, the IRS Restructuring and Reform Act of 1998 (RRA 98) introduced the concept of accepting OICs based on effective tax administration (ETA).<sup>10</sup> The Conference Report accompanying RRA 98 provides this additional guidance:

[T]he conferees believe that the *IRS should be flexible* in finding ways to work with taxpayers who are sincerely trying to meet their obligations and remain in the tax system. Accordingly, the conferees believe that the IRS should make it easier for taxpayers to enter into offer in compromise agreements, and should do more to educate the taxpaying public about the availability of such agreements.<sup>11</sup> (emphasis added)

Offers in compromise based on ETA provide the IRS the flexibility to consider all of the circumstances that led to a delinquency. The IRS can accept ETA offers even if it could achieve full collection when such collection would create an economic hardship for the taxpayer or when “compelling public policy or equity considerations” are identified by the taxpayer.<sup>12</sup>

In her 2012 Annual Report to Congress, the National Taxpayer Advocate reiterated her recommendation that the IRS promote the use of offers in compromise as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances.<sup>13</sup> In practice, the IRS has

<sup>7</sup> See Lorraine Mirabella, *Payroll Firm Accupay Is Investigated for Allegedly Stealing Clients' Tax Payments*, BALTIMORE SUN, Mar. 4, 2013, available at [http://articles.baltimoresun.com/2013-03-04/business/bs-bz-accupay-investigation-20130304\\_1\\_tax-payments-tax-collectors-potential-victims](http://articles.baltimoresun.com/2013-03-04/business/bs-bz-accupay-investigation-20130304_1_tax-payments-tax-collectors-potential-victims); Angus Loten, *Tax Surprises Can Follow When Payroll Firms Implode*, WALL ST. J., Apr. 24, 2013, available at <http://online.wsj.com/news/articles/SB10001424127887324743704578442901672516758>.

<sup>8</sup> *Id.*

<sup>9</sup> IRS, SERP Alert 13A0213, *Contact Regarding AccuPay* (May 14, 2013).

<sup>10</sup> For an in-depth discussion of the IRS's OIC authority, see Most Serious Problem: *OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise*, *supra*.

<sup>11</sup> H.R. CONF. REP. NO. 105-599, at 289 (1998).

<sup>12</sup> See Treas. Reg. § 301.7122-1(b)(3)(ii).

<sup>13</sup> National Taxpayer Advocate 2012 Annual Report to Congress 444 (“revise the IRM and training materials to promote the use of ETA OICs as a viable collection alternative for victims of failed PSPs, including compromising the amount of tax in appropriate instances”). See also National Taxpayer Advocate 2007 Annual Report to Congress 342 (“interim guidance regarding the use of the ETA authority should do more to encourage IRS personnel to compromise tax liability in these situations”).

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**The IRS does not track the number of Payroll Service Provider victims, but even considering only the approximately 500 to 600 employers impacted by the AccuPay bankruptcy, accepting 54 non-economic hardship Effective Tax Administration offers over the past two years is hardly the “flexible” use that Congress intended.**

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not embraced its ETA OIC authority and has consistently underutilized this tool to provide relief to victims. For example, in fiscal years (FYs) 2013 and 2014, the IRS accepted only 54 non-economic hardship ETA offers submitted by victims of PSPs.<sup>14</sup> The IRS does not track the number of PSP victims, but even considering only the approximately 500 to 600 employers impacted by the AccuPay bankruptcy, accepting 54 non-economic hardship ETA offers over the past two years is hardly the “flexible” use that Congress intended.

Unsatisfied with the lack of the IRS’s interest in the use of its ETA OIC authority for victims of PSPs, Congress included language in the Consolidated Appropriations Act of 2014 specifically mandating that the IRS “shall give special consideration to an offer in compromise from a taxpayer who has been the victim of fraud by a third party payroll tax preparer.”<sup>15</sup> It is clear that Congress wants the IRS to do more to assist victims of PSP failure.

Yet in its response to this congressional directive, the IRS fails to even acknowledge these taxpayers as victims who need special assistance. The Commissioner’s May 2014 letter simply states that an “employer’s use of a PSP does not relieve the employer of its employment tax obligations or liability for employment taxes.” The IRS does not acknowledge that the taxpayers’ specific facts and circumstances may warrant a compromise of those obligations or liabilities, as Congress directed the IRS to do and as the TBOR promises.

### *Interim Guidance in Response to Congressional Directive*

During the summer of 2014, TAS worked with the IRS to develop an interim guidance memorandum (IGM) that supplements its Internal Revenue Manual (IRM) section on OIC.<sup>16</sup> Its stated objective is to:

allow the offer specialist to investigate and process offers submitted by taxpayers impacted by the fraudulent acts of a PSP in the most expeditious manner possible. The attached procedures require taxpayers to submit the least amount of documentation necessary to complete the offer investigation and allow for a resolution which is in the interest of both the taxpayer and the government.<sup>17</sup>

Though skeptical of the term “expeditious” and noting that it is often interpreted as “most convenient for the IRS” rather than “effective” or “correct,” the National Taxpayer Advocate is generally pleased with the additional guidance. While there is no “silver bullet” solution for this problem, this IGM provides Collection employees much more flexibility to use ETA authority in these cases.

14 See IRS response to TAS information request (Aug. 8, 2014); IRS response to TAS information request (Aug. 11, 2014); IRS response to fact check (Dec. 8, 2014). While the IRS does not systemically track the number of OICs submitted by victims of PSPs, it stated that it knew of 33 such offers received in FY 2013 and 57 in FY 2014. See IRS response to fact check (Nov. 26, 2014).

15 Consolidated Appropriations Act, Pub. L. No. 113-76, Division E, Title I, § 106 (2014).

16 Memorandum from Rocco A. Steco, Acting Director, Collection Policy, *Interim Guidance on Offers in Compromise from Taxpayers When Payroll Service Provider Issues Are Present* (Sept. 16, 2014). This guidance supplements the procedures found in IRM 5.8.11.2.2.1, *Public Policy or Equity Compelling Factors* (Sept. 23, 2008), IRM 5.8.11.5, *Documentation and Verification* (Sept. 23, 2008), IRM 5.8.4.22.1, *Trust Fund Liabilities* (May 10, 2013), and IRM 5.8.8.4, *Closing a Case as an Acceptance* (Aug. 8, 2014), and will be incorporated into the next revision of these IRM sections.

17 *Id.*

From the outset, the IGM acknowledges that these taxpayers are victims of a crime. This is the perspective that the National Taxpayer Advocate believes Congress intended the IRS adopt. The IGM takes a more taxpayer-favorable approach than before in discussing how to determine if the victims acted in a reasonable manner in selecting a PSP. For example, whether the PSP was licensed and bonded is just one of many factors to consider, not a dispositive factor.

Most significantly, Collection has backed away from requiring full payment of the outstanding tax balance (exclusive of penalty and interest), as the minimum offer amount. In other words, the IRS will compromise tax under certain conditions—which shows a significant commitment to treating taxpayers harmed by PSPs as victims. Furthermore, the guidance allows for acceptance of an ETA OIC without financial analysis if the taxpayer can and will agree to offer the tax balance (exclusive of penalty and interest).

Once the Collection employee has determined the PSP victim acted reasonably and its failure to comply is directly due to the actions of a third party, the IGM provides an expanded set of factors to consider in determining a reasonable offer amount in these cases. For example:

- Will payment of the full reasonable collection potential (RCP) or the remaining tax balance (exclusive of penalty and interest):
  - Negatively impact the ability of the taxpayer to pay current and future expenses in a timely manner?
  - Potentially result in the need for the taxpayer to lay off employees?
  - Reduce the goods or services provided to the community?
  - Impair the ability of the taxpayer business to remain operational?
  - Negatively impact the local economy if the business fails?
- Will payment of less than the calculated RCP or the remaining tax balance (exclusive of penalty and interest):
  - Result in providing a financial gain for the taxpayer?
  - Be generally perceived within the community as a fair and equitable solution?

The National Taxpayer Advocate believes the inquiry of whether the offer amount will result in a financial gain for the taxpayer is irrelevant to offer acceptance. This factor indicates that the IRS is still thinking that somehow, by relieving a PSP victim of the employment tax liability, the taxpayer will obtain some economic advantage over its competitors. Yet the very fact that the taxpayer has already paid the PSP the amount of the tax means that the taxpayer will be economically *disadvantaged*, vis-à-vis its competitors, by paying the amount twice.

Given this underlying emphasis on enforcement, the National Taxpayer Advocate is concerned that the IRS is not comfortable with making an objective assessment of whether an accepted offer would be perceived as fair and equitable by the community. One possible solution to this concern is for the National

Taxpayer Advocate, as the voice of the taxpayer within the IRS, to make this assessment.<sup>18</sup> The relevant inquiries are:

- Whether the taxpayer exercised good judgment in utilizing this particular PSP;
- Whether the taxpayer timely paid the payroll taxes and withholding to the PSP; and
- Whether the taxpayer took appropriate steps to mitigate its loss (including paying over any insurance proceeds received as a result of the loss).

The National Taxpayer Advocate continues to have concerns about both the substance and implementation of the new guidance, as discussed above. After decades of treating ETA OICs as a rare occurrence—recall that the IRS accepted only 54 OICs based on ETA from victims of PSPs in FYs 2013 and 2014—it will be a challenge to change the culture of the organization to provide special consideration of OICs for victims of PSPs. This message should be reiterated by top-level executive communications from Small Business/Self-Employed Division (SB/SE) leadership.

Once the IRS has revised its guidance and approach, it must develop and deliver comprehensive training to its staff, including all Revenue Officers and Centralized OIC employees. Revenue Officers must be directed to forward OICs submitted by victims of PSP failure for ETA consideration as soon as they are identified. Without the appropriate training to supplement the revised guidance, it will be difficult to achieve the culture change.

The guidance in this IGM will be the basis for a new section of IRM 5.8.11 that specifically addresses the PSP issue. In addition, the IRS should update IRM 5.7, *Trust Fund Compliance*, to include a discussion of the use of ETA OICs in these cases. IRM 5.7 should direct Revenue Officers to assist PSP victims in submitting OICs, and getting them to the Centralized OIC group without delay.

Finally, SB/SE executives must continue to monitor activity in this area to ensure that employees actually follow the new guidance. For example, if the IRS accepts only a few dozen ETA OICs on this issue in FY 2015, we would be concerned that the IRS is only giving lip service to Congress with respect to victims of PSP malfeasance.

## CONCLUSION

Many small businesses rely upon payroll service providers to meet their employment tax reporting and payment obligations. Unfortunately, there have been many instances where PSPs have failed to remit the proper amount of tax deposits on behalf of their clients. The IRS has been reluctant to take steps to (1) reduce the likelihood of the fraud by issuing dual notices whenever an address change is requested, and (2) exercise the full extent of its authority to accept offers in compromise based upon effective tax administration principles. Unsatisfied with the lack of IRS action, Congress mandated in January 2014 that the IRS issue dual notices for address changes and give special consideration to OICs submitted by victims of PSP fraud. The IRS Commissioner assured Congress that the IRS would comply with the mandate. The National Taxpayer Advocate will continue to work with the IRS to ensure it addresses both mandates.

<sup>18</sup> See Legislative Recommendation: *OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable,”* *infra.*.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that SB/SE:

1. Amend its interim guidance and IRM to incorporate the changes suggested by the National Taxpayer Advocate.
2. Develop and deliver comprehensive training to all Revenue Officers and Centralized OIC employees on the new guidance for reviewing and processing ETA OICs submitted by victims of PSP failure.
3. Update IRM 5.7, *Trust Fund Compliance*, instructing Revenue Officers to pass on OICs submitted by PSP victims to the centralized OIC group without delay.

**MSP  
#22****MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division

Karen Schiller, Commissioner, Small Business/Self-Employed Division

**DEFINITION OF PROBLEM**

One of the IRS's most significant powers is its authority to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes. The NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders.<sup>1</sup> Unlike most other creditors, the IRS does not need a judgment from a court to file an NFTL.<sup>2</sup> When properly applied, the IRS's lien authority can be an effective tool in tax collection. However, when improperly applied, NFTLs can needlessly harm taxpayers and undermine long-term tax collection.

Specifically, filing an NFTL can significantly harm the taxpayer's creditworthiness and thus impair his or her ability to:

- Obtain financing for a home or other major purchase;
- Find or retain a job;
- Secure affordable housing or insurance;<sup>3</sup> and
- Ultimately pay the tax debt.<sup>4</sup>

Badly damaging the taxpayer's financial circumstances in this way may even require the government to provide welfare benefits to the taxpayer, such as unemployment benefits or food stamps.

Aware of the serious impact and hardship NFTLs can cause in a taxpayer's life,<sup>5</sup> Congress enacted § 3421 of RRA 98 to preclude the IRS from "abusively us[ing] its liens-and-seizure authority."<sup>6</sup> The law requires the IRS to adopt procedures in which an employee's determination to file an NFTL would, "where appropriate," be approved by a supervisor and to set out disciplinary actions when such approval is not obtained.<sup>7</sup>

1 Internal Revenue Code (IRC) §§ 6321, 6322, and 6323(a).

2 IRC §§ 6321, 6322, and 6323(a). IRS collection actions are either taken by the Automated Collection System (ACS) or Revenue Officers (ROs). ROs work in field offices and can send letters, issue liens and levies, and answer calls. ACS is a computerized inventory system that sends taxpayers notices demanding payment, issues liens and levies, and answers telephone calls in an effort to resolve balance due accounts and delinquencies.

3 Heather Struck, *A Bad Credit Score Affects A Lot More Than Credit*, FORBES, Jul. 20, 2011, available at <http://www.forbes.com/sites/heatherstruck/2011/07/20/credit-score-fico-can-hurt-you/>.

4 Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

5 *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong., (1998) (see, e.g., statements of Nina E. Olson, Executive Director of the Community Tax Law Project in Richmond, Virginia).

6 RRA 98, Title III, § 3421, Pub. L. No. 105-206, 112 Stat. 758 (1998). See also S. REP. No. 105-174, at 78 (1998); Unanimous Consent Request - H.R. 2676, 143 Cong. Rec. S12230-02 (statement of Sen. Roth).

7 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

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**Aware of the serious impact and hardship that lien filings can cause in a taxpayer's life, Congress enacted section 3421 of the IRS Restructuring and Reform Act of 1998 to preclude the IRS from "abusively using its liens-and-seizure authority."**

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The IRS has deemed that it is rarely "appropriate" to require such approval, because it has made virtually no adjustments to its procedures along the lines of what Congress directed in enacting § 3421 of RRA 98. In fact, the IRS has adopted a collection strategy that often relies on *broad* use of its lien authority.<sup>8</sup> Notably, the IRS has eased previous restrictions on NFTL filings by allowing lower-graded employees to file NFTLs without managerial approval.<sup>9</sup> The IRS also flipped Congress's intent on its head by requiring employees to obtain managerial approval if they determine *not* to file an NFTL or defer filing in many circumstances.<sup>10</sup> Further, the IRS never established appropriate disciplinary actions for employees who fail to secure managerial approval to file an NFTL when such approval is required (*i.e.*, Revenue Officers (RO) below GS-9).<sup>11</sup>

The National Taxpayer Advocate has conducted several significant research studies which show not only that this lien filing approach is ineffective in terms of collecting revenue but that it actually impairs current and future payment compliance and the taxpayer's earnings, and has particularly harmful effects on taxpayers whom the IRS has classified as "currently not collectible" (CNC) because of economic hardship.<sup>12</sup>

A meaningful implementation of Congress's directive would not only better protect the taxpayers' right *to a fair and just tax system*, but would also prevent further harm to taxpayers experiencing economic hardship, while establishing a more effective approach to collecting outstanding liabilities.<sup>13</sup>

## ANALYSIS OF PROBLEM

### Background

#### *A Federal Tax Lien is a Powerful Collection Tool.*

A Federal Tax Lien (FTL) arises when the IRS assesses a tax liability, sends the taxpayer notice and demand for payment, and the taxpayer does not fully pay the debt within ten days.<sup>14</sup> An FTL is effective as of the date of assessment and attaches to all of the taxpayer's property and rights to property, whether real or personal, including those acquired by the taxpayer after that date.<sup>15</sup> This lien continues against the taxpayer's property until the liability either has been fully paid or is legally unenforceable.<sup>16</sup> This

8 Internal Revenue Manual (IRM) 5.12.2.6, *NFTL Filing Criteria* (Oct. 14, 2013).

9 IRM 1.2.44.5, *Delegation Order 5-4* (May 9, 2013); IRM 5.19.4.5.3.4, *When Filing an NFTL Requires Approval* (Aug. 4, 2014).

10 IRM 5.12.2.5.3, *NFTL Do-Not-File and Filing Deferral Determination Approvals* (Oct. 14, 2013); 5.19.4.5.2.1, *Do Not File Approvals* (Aug. 4, 2014).

11 IRS response to TAS information request (July 31, 2014) and IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

12 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS's Use of Notices of Federal Tax Lien*). Taxpayer accounts are reported as currently not collectible when the taxpayer has no assets or income, which by law, are subject to a levy. IRM 1.2.14.1.14, *Policy Statement 5-71* (Nov. 19, 1980).

13 IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights>.

14 IRC §§ 6321 and 6322. IRC § 6201 authorizes the IRS to assess all taxes owed. IRC § 6303 provides that within 60 days of the assessment the IRS must provide notice and demand for payment to any taxpayer liable for an unpaid tax.

15 See IRC § 6321; IRM 5.12.1.3, *Creation and Duration* (Oct. 14, 2013).

16 IRC § 6322.

statutory lien is sometimes called the “secret” lien, because third parties—and usually the taxpayer—have no knowledge of the existence of this lien or the underlying debt, and the taxpayer may not understand the significance of this statutory lien.<sup>17</sup>

However, the FTL does not give the IRS priority over other creditors. The IRS must file an NFTL in the county or similar jurisdiction where a taxpayer’s property is located, such as with a register of deeds, to put third parties on notice and establish the priority of the government’s interest in the taxpayer’s property against subsequent purchasers, secured creditors, and junior lien holders.<sup>18</sup>

The IRS is required to release a lien not later than 30 days after the underlying liability either is fully satisfied through full payment of tax or becomes legally unenforceable (typically, upon expiration of the statutory period for collecting the tax).<sup>19</sup> Once the certificate of release is issued and filed in the same office as the related NFTL, the tax lien is conclusively extinguished.<sup>20</sup>

### *NFTL Filing Has Significant Consequences for the Taxpayer.*

As mentioned above, the NFTL filing negatively impacts a taxpayer’s credit history,<sup>21</sup> having the potential of reducing a taxpayer’s credit score by 100 points,<sup>22</sup> and has a long-lasting effect on the taxpayer’s financial viability. For example, the existence of the NFTL filing, and the information contained in the notice, are included in the consumer (credit) reports,<sup>23</sup> which can impair a taxpayer’s ability to obtain financing,<sup>24</sup> find or keep a job,<sup>25</sup> and secure affordable housing or insurance.<sup>26</sup> It can also hamper the taxpayer’s ability to stay compliant and obtain credit needed to pay preexisting tax debts.<sup>27</sup>

The taxpayer may experience effects of the NFTL filing long-term, because a NFTL filing will remain on a taxpayer’s credit report for years, or even indefinitely. Specifically, “paid tax liens” appear on credit

17 IRC § 6321. The IRM refers to this statutory lien also as the “assessment” or the “silent” lien. See IRM 5.12.1.2, *Introduction to Liens* (Oct. 14, 2013).

18 IRC § 6323(f); Treas. Reg. § 301.6323(f)-1; IRM 5.12.1.4, *Purpose and Effect of Filing a Notice of Federal Tax Lien (NFTL)* (Oct. 14, 2013).

19 IRC § 6325(a)(1).

20 IRC § 6325(f).

21 It is difficult to speculate as to the degree to which an NFTL will affect a taxpayer’s credit score, because every individual’s situation is different, and there are many different credit scoring systems. Therefore, the impact on one system could be very different from another because the numeric scales are different. See Experian, *A World of Insight*, available at <http://www.experian.com/ask-experian/20080903-tax-liens-and-credit-scores.html> (last visited Dec. 12, 2014). However, a recent IRS study conducted by Experian found that NFTLs have a minimal impact on many consumers’ credit scores. See IRS and Experian Decision Analytics, *Federal Tax Lien Impact Study* (Mar. 31, 2014).

22 Written response from Vantage Score® (Sept. 17, 2009). The impact of the NFTL filing is greatest upon the initial filing and diminishes over time.

23 The term “consumer report” is defined in the FCRA, § 603(d), 15 USC § 1681a(d). Hereinafter, we will use the more commonly used term “credit report.”

24 Some lenders decline to extend credit to a taxpayer if the IRS has filed an NFTL against the taxpayer’s property. Others will charge substantially higher rates, even if the lien is subordinated. See, e.g., GMAC Factoring Agreement, available at <http://contracts.onecle.com/arbnet/gmac.factor.2003.02.01.shtml> (last visited Dec. 13, 2014).

25 Some licensing boards require members to maintain a clean credit history and some employers require employees to do so as a condition of employment. See, e.g., Form U4, *Uniform Application for Broker-Dealer Registration*, Q14M (May 2009), available at <http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/appsupportdocs/p015112.pdf> (last visited Dec. 13, 2014).

26 See also IRS Pub. 594, *What You Should Know About the IRS Collection Process* 4 (Apr. 2012) (recognizing the taxpayer may not be able to get a loan to buy a house or a car, get a new credit card, or sign a lease as result of the NFTL filing).

27 See, e.g., IRC § 6323(d) (providing that security protection only extended to the lender for disbursements made within 45 days after the filing of the NFTL, or until the lender is provided actual notice of the NFTL); IRC § 3505(b) (holding a lender providing funds for the ongoing operation of a business potentially liable for unpaid withholding taxes if certain criteria are met).

reports for seven years from the date of payment,<sup>28</sup> and unpaid liens may remain on the taxpayer's credit report indefinitely, even when the underlying lien becomes legally unenforceable (*e.g.*, because the statute of limitations for collection has expired and the lien self-released or the lien is legally satisfied as a result of an accepted offer in compromise) or the IRS accepts a bond.<sup>29</sup> When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further damage his or her financial viability and generate significant downstream costs for the government.<sup>30</sup>

### *Congress Placed Limitations on IRS Lien Filing Authority, Recognizing the Impact of NFTL on Taxpayers.*

As a result of concerns raised by Congress and leaders in the tax community regarding the IRS's use of its NFTL authority,<sup>31</sup> Congress enacted § 3421 in RRA 98.<sup>32</sup> Under this provision, where deemed appropriate, a determination by an employee to file an NFTL would be approved by an IRS supervisor who would:

- Review the taxpayer's information;
- Verify that a balance is due; and
- Affirm that the action proposed is appropriate given the taxpayer's circumstances, the amount due, and the value of the property or right to property.<sup>33</sup>

Failure to follow these procedures should result in appropriate disciplinary action against the responsible supervisor or employee.<sup>34</sup> Congress delayed the application of RRA 98 § 3421 of RRA 98 until January 1, 2001 for IRS collection actions taken under the IRS Automated Collection System (ACS).<sup>35</sup>

The recently adopted Taxpayer Bill Of Rights supports Congress' analysis and its concern that collection actions be fair, balanced, and taken after carefully considering the taxpayer's facts and circumstances. The congressional directive of RRA 98 § 3421 relates directly to the *right to a fair and just tax system*, which

28 The Fair Credit Reporting Act (FCRA), § 605(a)(3), 15 USC § 1681c(a)(3). See also Federal Trade Commission, Statement of General Policy or Interpretation; Commentary on the Fair Credit Reporting Act, 55 Fed. Reg. 18804, 18818 (May 4, 1990). The filing of a release will be noted on the credit report but does not necessarily impact the credit score in a significant way.

29 As a matter of policy, Experian keeps unpaid tax liens on a credit report for 15 years while Equifax and Transunion credit reports reflect them indefinitely. See <http://www.transunion.com/personal-credit/credit-issues-bad-credit/what-affects-your-credit-score.page>; <http://www.experian.com/blogs/ask-experian/2007/05/16/how-long-public-records-stay-on-your-credit-report/>; <http://blog.equifax.com/credit/faq-how-long-does-information-stay-on-my-credit-report/> (last visited on Dec. 13, 2014). For example, most NFTLs are self-releasing, *i.e.*, the notice indicates that unless the IRS refiles it by the listed date, the notice operates as a certificate of release under IRC § 6325(a). IRC § 6325(a) also provides for a release of liens because the underlying liability became legally unenforceable or the IRS accepted a bond.

30 See T. Keith Fogg, *Systemic Problems With Low-Dollar Lien Filing*, 2011 TNT 194-9 (2011); National Taxpayer Advocate 2011 Annual Report to Congress 109-128 (Most Serious Problem: *Changes to IRS Lien Filing Practices are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*). A further consequence of a lien's damage to a taxpayer's financial viability may be a need for unemployment benefits, food stamps, and the like, thus increasing societal cost.

31 The Joint Committee on Taxation observed that "the imposition of liens, levies, and seizures may impose significant hardships on taxpayers" and "that extra protection in the form of an administrative approval process is appropriate." J. Comm. on Tax'n, *General Explanation of Tax Legislation Enacted in 1998*, (1998). See also *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance at 408*, 105th Cong., 375 (1998) (written statement of Bruce Strauss, Enrolled Agent) (suggesting among other things that tax liens filings "must all be reviewed by an independent IRS quality review function prior to implementation of the decision"); *Exploring the Development of Taxpayer Bill of Rights Legislation: Hearing Before the H. Comm. On Ways and Means*, 104th Cong. (1995) (statement of Joseph F. Lane, Enrolled Agent).

32 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

33 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

34 RRA 98, Title III, § 3421(b), Pub. L. No. 105-206, 112 Stat. 758 (1998).

35 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

means taxpayers have the right to expect that the tax system will consider facts and circumstances that might affect their ability to pay.<sup>36</sup>

**The IRS has not implemented Congress' directive, and has embraced a broad NFTL filing policy with little managerial review.**

Since Congress enacted § 3421 in RRA 98, the IRS has:

1. Restated its policy that only ROs below the GS-9<sup>37</sup> level must receive managerial approval prior to filing an NFTL.<sup>38</sup> The IRS stated the costs and administrative burden of expanding the § 3421 protection to other situations outweighed the taxpayer's interest.<sup>39</sup> This approval requirement for ROs below the GS-9 level applies to only less than one percent of ROs.<sup>40</sup>
2. Eased managerial approval requirements for NFTL filings. Specifically, despite the fact that Congress gave the IRS more than two years to determine how to implement § 3421 of RRA 98 for ACS,<sup>41</sup> the only change the IRS made was to grant ACS employees in grades as low as GS-6 the authority to file NFTLs without managerial review.<sup>42</sup> This change was contrary to Congress's directive and more lax than prior ACS guidance, which required GS-7 employees and below to obtain approval from either a senior RO or a manager to file an NFTL.<sup>43</sup> Presently, ACS files about one third of NFTLs, and very few require managerial approval<sup>44</sup> (*i.e.*, only about 6.2 percent of ACS employees are below GS-6, so more than 90 percent of ACS employees can file NFTLs without any managerial review).<sup>45</sup>
3. Required all ACS employees and ROs, regardless of grade level, to obtain managerial approval if they determine *not* to file an NFTL in cases that meet specified criteria.<sup>46</sup>
4. Never established disciplinary action for employees who fail to secure managerial approval where required.<sup>47</sup>

36 See IRS, Taxpayer Bill of Rights, available at <http://www.irs.gov/Taxpayer-Bill-of-Rights> (last visited Aug. 20, 2014) and Publication 1, *Your Rights as a Taxpayer* (June 2014).

37 The General Schedule (GS) classification and pay system covers the majority of civilian white-collar Federal employees (about 1.5 million worldwide) in professional, technical, administrative, and clerical positions. U.S. Office of Personnel Management, available at <http://www.opm.gov/policy-data-oversight/pay-leave/pay-systems/general-schedule/> (last visited Dec. 4, 2014). Within the Collection function, a "GS-9" employee is relatively junior.

38 IRM 5.12.2.5.2, *NFTL Filing Determination Approvals* (Oct. 14, 2013).

39 Memorandum from Assistant Commissioner (Collection) (July 30, 1998) (concluding section 3421 does not require supervisory review of all collection actions but allows the IRS discretion to determine where such review would be appropriate); Memorandum from Chief, Branch 1, General Litigation Division to Counsel to the National Taxpayer Advocate, Ref. No. GL-122444-98 (Dec. 23, 1998) (same).

40 IRS Human Resources Reporting Center, Workforce Information by Organization Query on Revenue Officers (Dec. 9, 2013). For instance, as of July 26, 2014, less than one percent of ROs were below the GS-9 level. GS-8 and lower-graded revenue officers totaled two out of 3742 revenue officers. Also, the NFTLs issued by ROs below the GS-9 level may still not be reviewed by a manager. The IRM permits a manager to assign the NFTL review responsibility to another RO at an "appropriate" grade level. (emphasis added). See IRM 5.12.2.7, *Approval of Lien Filing Notice* (Oct. 14, 2013).

41 RRA 98, Title III, § 3421(a)(2), Pub. L. No. 105-206, 112 Stat. 758 (1998).

42 IRM 1.2.44.5, *Delegation Order 5-4* (May 9, 2013); IRM 5.19.4.5.3.4, *When Filing an NFTL Requires Approval* (Aug. 4, 2014).

43 Email from former IRS Chief Compliance Officer to the National Taxpayer Advocate (Nov. 2, 2009) (on file with TAS).

44 IRS No 5000-25, Lien Report, FY 2013 and 2014. ACS filed 204,279 and 198,682 NFTLs out of 602,005 and 535,580 total NFTL filings for FY 2013 and FY 2014, respectively.

45 IRS Human Resources Reporting Center, Position Report Query, ACS employees (no exec), All GSs and GS-5 and less, run date 11/14/2014. As of Nov. 1, 2014, 159 employees out of 2,571 ACS employees were below the GS-6 level.

46 IRM 5.19.4.5.2, *Do Not File Decisions* (Aug. 4, 2014).

47 IRS response to TAS information request (July 31, 2014).

Essentially, the IRS ignored Congress’s directive and elected to adopt an even broader NFTL filing policy, rather than one that emphasizes review of taxpayers’ particular facts and circumstances to ensure the NFTL will attach to assets and not cause hardship.

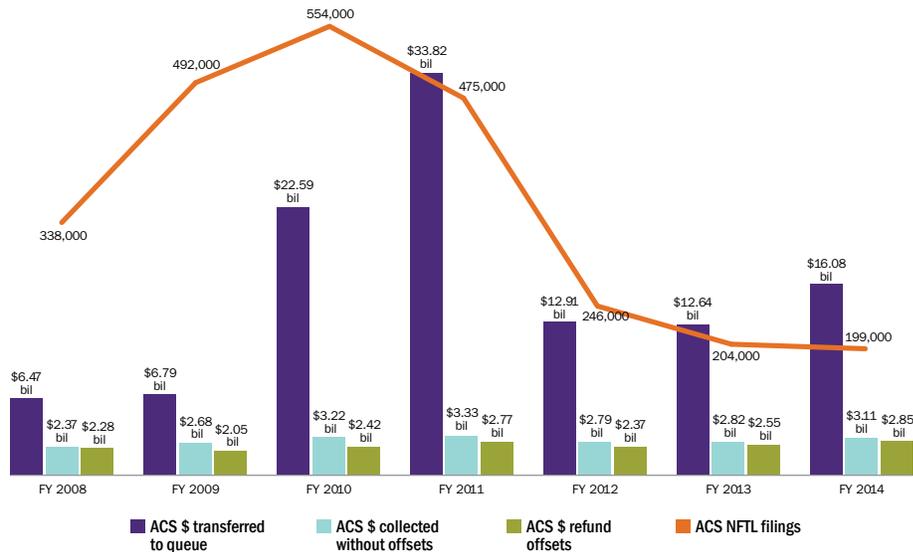
**The current NFTL filing policy has been ineffective in collecting revenue.**

The IRS files many NFTLs, pursuant to “business rules” that require automatic NFTL filing or a lack of substantive human review.<sup>48</sup> The reliance on merely following business rules when filing of NFTLs has contributed to a significant increase in the number of NFTLs filed. For example, NFTL filings rose by about 219 percent from fiscal year (FY) 1999 to 2014,<sup>49</sup> yet the Collection function is collecting only slightly more in real 2014 dollars than in 1999.<sup>50</sup>

The NFTL filing strategy also has been ineffective for the ACS function. ACS systemically takes collection action when “business rules” that require automatic filing of an NFTL are met, rather than reviewing the particular facts and circumstances of each case.<sup>51</sup> As the chart below illustrates, this approach has been ineffective in collecting revenue.

**FIGURE 1.22.1**<sup>52</sup>

**Selected ACS collection activities and number of ACS NFTLs filed, FYs 2008-2014**



48 IRM 5.19.4.5.3.2, *Filing Criteria* (Aug. 4, 2014).

49 IRS Data Book, Table 16 (Nov. 19, 2014). NFTL filings were 168,000 and 535,580 for 1999 and 2014, respectively.

50 IRS Data Book, Table 16 (Nov. 19, 2014). When adjusted for inflation (converted to 2014 dollars) the IRS collected about \$32.1 billion in FY 1999 and about \$34.2 billion in FY 2014.

51 ACS Customer Service Activity Reports (CSAR), FY 2009 BOD report. See also E-mail from IRS subject matter expert (Nov. 2, 2009); IRM 5.19.4.5.3.2, *Filing Criteria* (Aug. 4, 2014).

52 Collection Report, NO 5000-2, Part 1 - TDAs, ACS/CS TDAs, FY 2008–FY 2014 and Collection Report, NO 5000-256, Lien Report, FY 2010–FY 2014. Note that the chart shows that the number of NFTLs filed by ACS has dropped dramatically since 2010, however, dollars collected have increased slightly.

ACS collected only about 5.9 percent of the dollars placed in its inventory, and this is only about a half percent more than the IRS obtained by refund offsets, which do not require an NFTL.<sup>53</sup> Nevertheless, ACS filed 198,682 liens.<sup>54</sup> Yet, ACS ultimately transfers much of its inventory to the Queue.<sup>55</sup> Thus taxpayers are harmed both by having unnecessary NFTLs filed and by being transferred to the “inactive” status in the Queue.

Despite this performance, ACS continues to automatically file NFTLs, using them to establish contact with delinquent taxpayers. Contrary to this practice, one IRS study showed establishing contact with taxpayers through letters, rather than a collection action, was a more effective approach.<sup>56</sup>

### The current IRS NFTL filing policy harms taxpayers experiencing economic hardship and may undermine future compliance and revenue.

Taxpayer accounts placed in CNC status because the IRS was either unable to contact or locate the taxpayer, or it determined that the taxpayer was in economic hardship, are subject to NFTLs as long as certain requirements are met (*i.e.*, the tax liability is \$10,000 or greater).<sup>57</sup> As a result of these rules, the IRS systemically files NFTLs against CNC (hardship) taxpayers who in most cases have no assets.<sup>58</sup> When a taxpayer has little or no ability to pay and no assets from which to collect, an NFTL filing may further impede the taxpayer’s financial viability and ultimately undermine tax revenue and future compliance. In addition, if the NFTL badly damages the taxpayer’s family by driving up costs or rendering the taxpayer jobless or underemployed, the government may be forced to provide a social safety net in the form of unemployment benefits, food stamps, and the like, thus increasing societal cost, raising everyone’s share of taxes, and eroding the core taxpayer *right to a fair and just tax system*.

### TAS research studies show the IRS’s NFTL filing approach, void of human consideration, is ineffective, harms taxpayers, and damages future compliance.

TAS Research & Analysis has conducted several in-depth studies on the IRS’s use of NFTLs and their impact on the compliance behavior of delinquent taxpayers.<sup>59</sup> One study analyzed taxpayers who had an NFTL filed against them in 2002 and taxpayers who did not have an NFTL filed against them for the same time period. The study analyzed the effects of an NFTL, or no NFTL, from 2002 through 2010

53 In FY 2014, ACS collected \$3,107,887,286 out of \$52,254,945,879 placed in ACS in FY 2014, and this is compared to \$2,850,701,610 in refund offsets. IRS NO 5000-2, Part 1 - TDAs, ACS/CS TDAs.

54 Collection Report, NO 5000-25, Lien Report, FY 2014.

55 The Queue is a holding inventory where collection cases sit, sometimes for years, usually after being in ACS, and before being assigned to the Collection Field function or reassignment to ACS. Cases sit in the Queue based on business rules and available resources.

56 ACS Telephone Response Study, Kansas City Customer Service Site (Mar.–Apr. 2000). In this study conducted in 2000, the response rate for levies was about 13 percent, while the response rate for Letter 16, *Please Call Us About Your Overdue Taxes or Tax Return*, was nearly 37 percent.

57 IRM 5.12.2.6, *NFTL Filing Criteria* (Oct. 14, 2013). The IRM states: Currently Not Collectible—File a NFTL when BOTH of the following conditions exist: Aggregate assessed balance is at or above \$10,000 Account is being closed using unable to locate (cc03), unable to contact (cc12) or hardship (cc24 through 32) provisions.

58 *Id.*

59 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS’s Use of Notices of Federal Tax Lien*).

(the study period).<sup>60</sup> The research showed that NFTL filing was associated with negative outcomes for payment compliance behavior on the taxpayers' initial liabilities, negative filing compliance behavior, and negative impacts on the amount of income earned by taxpayers in years following the NFTL. Specifically,

- At the end of the study period (calendar year 2010), taxpayers with NFTLs owed 21 percent more on average than they owed when the NFTLs were filed, which was when they incurred their original liabilities in 2002. In contrast, where no NFTL had been filed, taxpayers owed 11 percent more than they owed on their total individual liability at the proxy lien date (2002).<sup>61</sup>
- NFTL taxpayers were less likely to file required returns, with the increased likelihood of non-filing ranging between about one and three percent during the full study period (through 2010).<sup>62</sup>
- NFTL taxpayers were less likely to have an increase in their total positive incomes (TPI) with the increased likelihood of negative outcomes starting at about 7.9 percent and gradually declining to about 5.2 percent by the end of the full study period.<sup>63</sup>

Additionally, these studies showed NFTLs were particularly ineffective when filed against CNC (hardship) taxpayers.

- For tax year (TY) 2009, TAS's analysis of NFTL filing practices showed NFTLs were responsible for only \$2 of every \$10 in payments collected from taxpayers in CNC status, while nearly \$6 of every \$10 collected from these taxpayers came from refund offsets, which occur whether a lien was filed or not.<sup>64</sup> Nonetheless, the IRS filed NFTLs against more than 72 percent of CNC taxpayers suffering economic hardship.<sup>65</sup>
- CNC hardship taxpayers, on average, ended up owing about 50 percent more to the IRS in 2010 than at the time of lien (or proxy lien) filing.<sup>66</sup>

This research also found that taxpayers with an installment agreement (IA) or offer in compromise (OIC) fared much better than others who did not secure such collection alternatives. Over 50 percent of IA

60 This analysis employed a two-phase approach. In phase 1, TAS Research analyzed a cohort of delinquent individual tax return filers (i.e., those who file Forms 1040, U.S. Individual Income Tax Return) who had any unpaid tax liabilities in 2002 and had no other liabilities at the beginning of that year. From these taxpayers, TAS identified taxpayers that the IRS filed NFTLs against and taxpayers it did not file NFTLs against from 2002-2004. TAS compared payment and filing compliance behavior of the two groups from the liabilities inception through 2010, and examined the impact the NFTLs had on taxpayers' incomes during this period. In phase 2, TAS used subsets of the lien and non-lien groups created in Phase 1 to look at the change in total tax liability of the taxpayer groups during the 2002-2010 study periods. TAS also looked at the total dollars the IRS actually collected from these taxpayer groups. National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*).

61 See National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 105-29 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

62 *Id.* The estimation results for the Study for lien coefficients in the current payment, future payment, future filings and future income models reported a high level of statistical significance for all models, at least at the one percent level. The lien coefficient measured the explanatory powers associated with a lien being present for delinquent taxpayers with respect to outcomes for the compliance issues or income. Negative signs indicate reduced compliance for the group, while positive signs imply more. The marginal effects were computed at the means of the sample variables.

63 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-112, (Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*). It should be noted that we did not adjust dollars for inflation. Therefore, the nominal decreases taxpayers experienced in TPI at the end of the study period (i.e., 2010) relative to their 2002 TPI are greater in real terms than equivalent nominal losses experienced earlier in the period.

64 National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (Research Study: *The IRS's Use of Notices of Federal Tax Lien*).

65 *Id.*

66 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

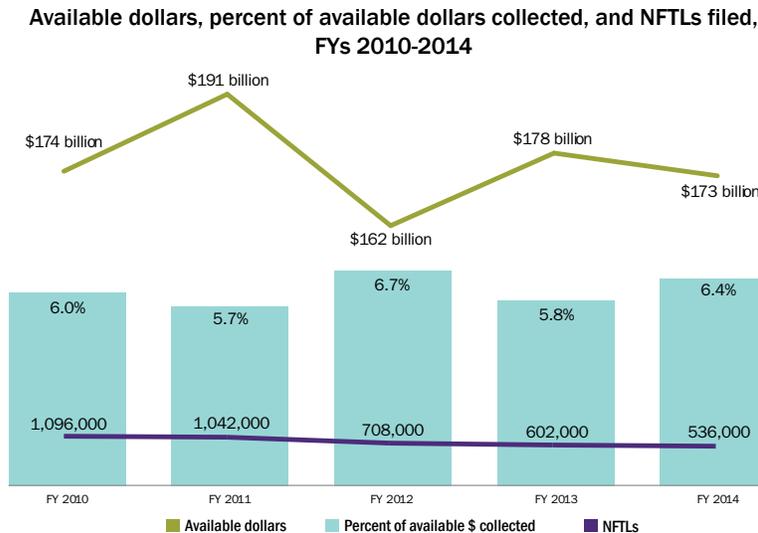
**The IRS systemically files liens against taxpayers in hardship, who in most cases have no assets. When a taxpayer has little or no ability to pay and no assets from which to collect, a lien filing may further impede the taxpayer's financial viability and ultimately undermine tax revenue and future compliance.**

taxpayers and 70 percent of OIC taxpayers were out of debt to the IRS at the end of the study period (2010).<sup>67</sup> The cumulative effect of these studies show that wholesale NFTL filings are ineffective and damage taxpayer compliance, and both the IRS and the taxpayer would be better served by an IA or OIC.

In response to these studies<sup>68</sup> and other advocacy efforts,<sup>69</sup> the IRS in early 2011 announced an effort to help financially struggling taxpayers get a “fresh start.”<sup>70</sup> This initiative included several positive changes in how the IRS files and withdraws NFTLs.<sup>71</sup> As a result, NFTL filings have declined from about 1,096,376 in FY 2010 to 535,580 in FY 2014, a decrease of 51 percent.<sup>72</sup>

If the filing of NFTLs were a significant driver of revenue collection, one would expect this dramatic decline in NFTL filings to produce a similarly dramatic decline in the amount of revenue the IRS Collection function collected on delinquent accounts. Yet the percent of dollars collected on delinquent accounts by the IRS Collection function has not shown a similar decrease, even though the dollars available for collection decreased slightly from FY 2010 to FY 2014, as depicted below.<sup>73</sup>

- 67 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-30 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).
- 68 See *id.* at 105-29; see also National Taxpayer Advocate 2011 Annual Report to Congress vol. 2 91-111 (*Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2 1-18 (*The IRS's Use of Notices of Federal Tax Lien*).
- 69 See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 124-33 (Most Serious Problem: *Collection Strategy: The Automated Collection System's Case Selection and Processes Result in Low Collection Yields and Poor Case Resolution, Thereby Harming Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 403-25 (Most Serious Problem: *Although the IRS "Fresh Start" Initiative Has Reduced the Number of Lien Notices Filed, the IRS Has Failed to Determine Whether Its Lien Policies are Clearly Supported by Either Increased Taxpayer Compliance or Revenue*); National Taxpayer Advocate 2011 Annual Report to Congress 109-28 (Most Serious Problem: *Changes to IRS Lien Filing Practices are Needed to Improve Future Compliance, Increase Revenue Collection, and Minimize Economic Harm Inflicted on Financially Struggling Taxpayers*); National Taxpayer Advocate 2010 Annual Report to Congress 302-10 (Most Serious Problem: *The IRS Has Been Slow to Address the Adverse Impact of its Lien-Filing Policies on Taxpayers and Future Tax Compliance*); National Taxpayer Advocate 2009 Annual Report to Congress 17-40 (Most Serious Problem: *One-Size-Fits-All Lien Filing Policies Circumvent the Spirit of the Law, Fail to Promote Future Tax Compliance, and Unnecessarily Harm Taxpayers*). See also TADs 2010-1 and 2010-2 (Jan. 20, 2010). For copies of the TADs, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, available at <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>.
- 70 IRS, Media Relations Office, *IRS Announces New Effort to Help Struggling Taxpayers Get a Fresh Start; Major Changes to Lien Process*, IR-2011-20 (Feb. 24, 2011). TAS worked very closely with the Collection function in developing and clearing procedural guidance related to the “Fresh Start” initiative.
- 71 ACS's systemic NFTL filing threshold was increased from \$5,000 to \$10,000, then to \$25,000 a few months later; and ACS established a systemic NFTL ‘floor’ amount on subsequent tax periods at \$2,500 or more. IRM 5.12.2.4.1, *Integrated Collection System (ICS) Documentation When Deferring the Filing of an NFTL or Choosing Do Not File* (Mar. 8, 2012); IRM 5.19.4.5.2, *Do Not File Decisions* (Mar. 14, 2012).
- 72 IRS Data Book, 2014, Table 16.
- 73 IRS Collection Reports, No 5000-2, Taxpayer Delinquent Accounts Report (Sept. 2014); No 5000-108, Monthly Report of Offer In Compromise Activity (Sept. 2014); No 5000-6, Installment Agreement Cumulative Report (Sept. 2014); and No 5000-25, Lien Report (Sept. 2014).

FIGURE 1.22.2<sup>74</sup>

These results are fully consistent with what the TAS studies have found. Ultimately, the IRS maximizes revenue collection by filing NFTLs in the right cases—not by filing NFTLs in large numbers of cases, triggered solely by arbitrary dollar amounts.

### The IRS should require managerial approval before filing an NFTL in specific situations.

As illustrated above, the IRS's current NFTL filing policy negatively affects collection results, taxpayers' income, and future compliance. The IRS's implementation of § 3421 of RRA 98 would better ensure that NFTLs are effective and do not create hardship. The National Taxpayer Advocate understands that requiring managerial approval prior to filing all NFTLs is not feasible or practicable. However, the IRS can identify specific situations in which requiring managerial approval would be appropriate and help to prevent useless and harmful NFTLs. These would include cases where it is likely that the lien will cause a hardship, will do little to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax. The following three categories are situations where the lien could have such an effect.

1. **Taxpayer's income falls below 250 percent of the federal poverty level:** Prior to filing an NFTL, an employee could review available information and determine if the taxpayer's income falls below 250 percent of the federal poverty level.<sup>75</sup> By identifying these taxpayers, the IRS can presume economic hardship (*i.e.*, inability to pay basic living expenses) and consider whether the

74 IRS Collection Reports, No 5000-2, Taxpayer Delinquent Accounts Report (Sept. 2014); No 5000-108, Monthly Report of Offer In Compromise Activity (Sept. 2014); No 5000-6, Installment Agreement Cumulative Report (Sept. 2014); and No 5000-25, Lien Report (Sept. 2014).

75 To determine taxpayer's income, employees could review taxpayer's most recent tax return, or third-party information it has available, whichever is more recent. See Department of Health and Human Services (DHHS), The 2014 HHS Poverty Guidelines, available at <http://aspe.hhs.gov/poverty/14poverty.cfm> (last visited on Nov. 14, 2014). For Calendar Year (CY) 2014, an individual who makes \$11,670 or less is in poverty. This number is then multiplied by 250 percent to determine the 250 percent federal poverty threshold.

lien will only cause further hardship.<sup>76</sup> The IRS already makes such a presumption when identifying low income taxpayers to filter out of the Federal Payment Levy Program (FPLP).<sup>77</sup>

2. **Taxpayers in CNC (hardship) status:** As shown above, taxpayers in CNC (hardship) status are often crippled by tax debt, and filing NFTLs against them does little to protect the government's interest, while most likely making the taxpayer's situation even worse.<sup>78</sup> The manager can consider whether the NFTL will actually assist in collecting the tax (*i.e.*, there are assets for the lien to attach to) or will only further harm the taxpayer.
3. **Taxpayers in a non-streamlined installment agreement:**<sup>79</sup> Taxpayers in an IA make significant strides toward paying off their tax debt.<sup>80</sup> Filing an NFTL against these taxpayers may jeopardize their ability to pay, because the NFTL can hinder their earning potential by threatening their credit rating and ability to secure financing or maintain professional licenses.

Requiring managerial approval in these situations would allow a supervisor to conduct a quality review of the determination to file an NFTL. This review would ensure that IRS employees have considered whether:

1. The NFTL would attach to property;
2. The benefit to the government of the NFTL filing outweighs the harm to the taxpayer, including consideration of any special circumstances pertaining to the taxpayer; and
3. The NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future.

If employees fail to secure managerial approval prior to filing an NFTL in these situations, the IRS should take disciplinary actions. A first-time violation should result in an admonishment along with the employee having to complete further training regarding when managerial approval is required before filing a NFTL. Subsequent violations should be met with stiffer consequences, including a written reprimand, or suspension.

76 IRC § 6343(a)(1)(D) requires the IRS to release a levy when it would create an economic hardship due to the financial condition of the taxpayer. Treas. Reg. § 301.6343-1(b)(4) specifies that an economic hardship exists if a taxpayer cannot pay his or her basic living expenses.

77 The FPLP is an automated system the IRS uses to match its records against those of the government's Bureau of the Fiscal Service (BFS) to identify taxpayers with unpaid tax liabilities who receive certain payments from the federal government. In 2011, the IRS finalized and implemented a low income filter. This filter's design was largely based on a TAS study, which tested a filter model that identified and removed from FPLP low income taxpayers the model showed would experience economic hardship. Largely accepting the findings from the TAS study, the IRS designed a filter that excluded taxpayers from the FPLP whose income fall below 250 percent of the federal poverty level. National Taxpayer Advocate 2008 Annual Report to Congress Vol. II, 46-72 (Research Study: Building a Better Filter: *Protecting Lower Income Social Security Recipients from the Federal Payment Levy Program*).

78 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-130 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

79 See IRM 5.14.5.1, *Installment Agreements Overview* (May 23, 2014): 1) Guaranteed agreements: under IRC § 6159(c) taxpayers who meet certain conditions and who have a delinquency \$10,000 or less are entitled to an installment agreement. 2) Streamlined agreement: streamline agreement criteria may be secured where the aggregate unpaid balance of assessments does not exceed \$25,000 and may be paid off within a 72 month period. Taxpayers who meet these criteria do not need to provide a financial information statement to the IRS. 3) Non-streamline agreement: agreements that fall outside the parameters of the guaranteed and streamlined IA.

80 National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 108-130 (Research Study: *Investigating the Impact of Liens on Taxpayer Liabilities and Payment Behavior*).

Requiring managerial approval before filing an NFTL in the above situations would better adhere the IRS's NFTL policy to Congress's directive. It also would protect taxpayers' *right to a fair and just tax system*, by creating an NFTL policy that considers each taxpayer's individual facts and circumstances.<sup>81</sup>

## CONCLUSION

Fifteen years after Congress determined the IRS should implement enhanced taxpayer protections in the form of managerial approval when it files NFTLs, the IRS still has not adequately changed its procedures to require such approval. To the contrary, the IRS has embraced a broader NFTL filing policy. This approach continues to harm taxpayers and yield poor collection results.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. In collaboration with TAS, develop and implement factors to determine situations in which managerial approval of NFTL filings is appropriate and should be required.
2. Develop and implement disciplinary actions to be taken when managerial approval prior to filing a NFTL is not secured in the specified situations.

<sup>81</sup> IRM 5.11.1.3.1, *Pre-Levy Considerations* (Aug. 1, 2014). The IRS has emphasized the need for such judgment in the context of making a levy determination by instructing revenue officers to exercise good judgment when making the determination to levy, which means they are to consider the taxpayer's financial condition.

**MSP  
#23****STATUTORY NOTICES OF DEFICIENCY: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notice****RESPONSIBLE OFFICIALS**

Debra Holland, Commissioner, Wage and Investment Division  
 Karen Schiller, Commissioner, Small Business/Self-Employed Division  
 William J. Wilkins, Chief Counsel

**DEFINITION OF PROBLEM**

Section 1102(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) provides that statutory notices of deficiency (SNODs) “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.”<sup>1</sup> However, our review of existing IRS SNODs found that more than half, or eleven out of 17 types of SNODs, fail to comply with the statutory requirements and instead include this information in a “stuffer” or insert. This noncompliance could impact millions of taxpayers. For example, the IRS issued almost 2.7 million Notices CP 3219A, *Statutory Notice of Deficiency*, in FY 2014.<sup>2</sup> While these notices are still valid, the failure of the IRS to comply with RRA 98 requirements harms taxpayers and violates the taxpayer’s *right to a fair and just tax system*.<sup>3</sup>

Congress enacted this provision of RRA 98 to ensure that taxpayers are aware of their right to contact the local office of the Taxpayer Advocate Service (TAS) at a crucial point in their tax controversy. Taxpayers need to know that they can talk to someone who is located in their state and has knowledge of the underlying local economic conditions that might affect the case. When the taxpayer receives a SNOD, the IRS has not actually assessed the additional tax, and the taxpayer still has a limited opportunity to address the issue directly with the IRS or petition the Tax Court. Seeking assistance from TAS at this juncture could prevent unnecessary burden on the taxpayer and unnecessary litigation for the IRS.

The IRS should provide the local contact information in an easily accessible and highly visible location on the face of all SNODs. Including the necessary contact information in a stuffer rather than on the face of the notice increases the risk that the taxpayer will not even see it.<sup>4</sup> Moreover, eliminating the stuffer could

- 1 Pub. L. 105-206, 112 Stat. 703 (1998). The RRA 98 provision amends IRC § 6212(a) to require the additional language on statutory notices of deficiency.
- 2 Notice CP 3219A is used when the Automatic Underreporter (AUR) program identifies a mismatch between what is reported on an individual’s return and a third-party information report. IRS Compliance Data Warehouse (CDW), Notice Delivery System, fiscal year 2014 (Nov. 2014).
- 3 See Taxpayer Bill of Rights, IRS Publication 1, *Your Rights as a Taxpayer*. The statutory notice is still valid without the language required by IRC § 6212(a). *John C. Hom & Associates, Ltd. v. Comm’r*, 140 T.C. 2010 (2013).
- 4 TAS, *2011 IRS Nationwide Tax Forums TAS Focus Group Report: Publication 1 – Taxpayer Rights*, 26-27 (2011) (overwhelming theme that taxpayers do not read the publication that is stuffed in the envelope with IRS notices).

potentially save mailing and printing costs or enable the IRS to apply those mailing and printing costs to notifying low income taxpayers about the availability of Low Income Taxpayer Clinics (LITCs).<sup>5</sup>

## ANALYSIS OF PROBLEM

### Background

The IRS issues a SNOD to notify a taxpayer that the IRS intends to assess a tax deficiency. The notice also informs the taxpayer of the right to petition the Tax Court to dispute the proposed adjustments. The taxpayer has 90 days from the date of the notice to file a petition in the Tax Court before the tax is assessed.<sup>6</sup>

Section 1102(b) of RRA 98 amended Internal Revenue Code (IRC) § 6212(a) to provide that SNODs “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.”<sup>7</sup> Furthermore, the Conference Report for RRA 98 states “The IRS would be required to publish the taxpayer’s right to contact the local Taxpayer Advocate on the statutory notice of deficiency.”<sup>8</sup>

By requiring the IRS to include TAS local office contact information on the Statutory Notice of Deficiency, Congress wanted taxpayers to know that they have the right to go to the local office of TAS to receive assistance at this important stage in their tax controversy.

In response to a request for legal opinion by TAS, the IRS Office of Chief Counsel has opined that the IRS complies with § 1102(b) of RRA 98 when it provides Notice 1214, *Helpful Contacts for Your “Notice of Deficiency,”* as an insert in the SNOD. Counsel reasoned that Notice 1214 was developed by the IRS for the purpose of complying with RRA 98. In fact, the description of the notice on the IRS Forms Repository site includes the following language: “This notice is issued to conform with the IRS restructuring and reform act of 1998 section 1102(b). It was included as an insert with all statutory notices of deficiency (90-Day Letters).” Counsel also supported its opinion by stating that the SNOD includes language regarding TAS and the Notice 1214 is listed as an enclosure on the SNOD.<sup>9</sup> The National Taxpayer Advocate vigorously disagrees with the legal reasoning of Counsel’s opinion.

The IRS Legislative Analysis, Tracking, and Implementation Services (LATIS) shows the IRS attempted to bring the notices into compliance between 1998 and 2002. Initially, TAS created, Notice 1214, that includes the addresses and phone numbers of the local TAS offices, and was initially designed to be included in the envelope with the SNOD. However, to conform with the actual language of the Conference Report, the IRS and TAS later acted to include the contact language *on* the SNODs themselves.<sup>10</sup>

5 The Printing and Postage Budget Reduction (PPBR) Implementation Team proposed eliminating all non-mandatory inserts as a way to reduce printing and postage costs. IRS Media & Publications, *PPBR Proposals Approved for Implementation (2010)*. Low Income Taxpayer Clinics represent low income individuals in disputes with the IRS, including audits, appeals, collection matters, and federal tax litigation. LITCs can also help taxpayers respond to IRS notices and correct account problems. Some LITCs provide education for low income taxpayers and taxpayers who speak English as a second language (ESL) about their taxpayer rights and responsibilities. IRC § 7526.

6 If the notice is addressed to a taxpayer outside the United States, the taxpayer has 150 days after the IRS mails the notice to file a Tax Court petition. IRC § 6213.

7 Pub. L. 105-206, 112 Stat. 703 (1998). The RRA 98 provision amends IRC § 6212(a) to require the additional language on statutory notices of deficiency.

8 H.R. CONF. REP. NO. 105-599, Title I, Section D (1998).

9 Email from Office of Counsel to the National Taxpayer Advocate (Nov. 20, 2014).

10 IRS, LATIS, Action ID No. AT-2009-12065 to -12076.

### Noncompliance with RRA 98 Requirements Will Harm Taxpayers at a Critical Point in a Tax Controversy.

The tenth taxpayer right in the Taxpayer Bill of Rights is *the right to a fair and just tax system*. That means, in part, that taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.<sup>11</sup> The IRS violates this right by not complying with the RRA 98 requirement to publish current and accurate information on the taxpayer's right to contact TAS, as well as accurate contact information for the closest office.<sup>12</sup> Providing the contact information as a stuffer in the SNOD envelope is not an effective way to deliver this information.

In focus groups about "Publication 1, Do Your Clients Understand Their Rights?" conducted by the Taxpayer Advocate Service (TAS) at IRS tax forums in 2011, an overwhelming theme heard throughout the six sessions was that nobody read the publication. The IRS sends the publication to taxpayers along with notices on issues ranging from audits to collection, but the focus group participants noted that the publication usually ended up in the trash can or was never even taken out of the envelope.<sup>13</sup> Furthermore, the use of inserts did not test well with focus groups in the Department of Treasury's Go Direct campaign to drive adoption of direct deposit.<sup>14</sup>

Congress required TAS to have at least one office in every state for two main reasons: (1) the convenience of the taxpayer and (2) the local office's awareness of underlying economic or other conditions in that state and how they might impact the taxpayer's case.<sup>15</sup> By requiring the IRS to include TAS local office contact information on the SNOD, Congress wanted taxpayers to know that they have the right to go to the local office of TAS to receive assistance at this important stage in their tax controversy.

Congress was very clear that it did not intend the IRS to merely give out a national contact number for TAS. Instead, by requiring the National Taxpayer Advocate to ensure that the phone numbers of the local offices are published, Congress specifically wanted taxpayers to know how to seek assistance from the local TAS office.<sup>16</sup> The Conference Report also provided further clarification by stating that the IRS should publish the information "on" the SNOD, as opposed to "with" the notice.<sup>17</sup>

The taxpayer's receipt of a SNOD is a critical point in the audit or appeals process. The taxpayer needs information about what he or she must do to protect the right to an independent review of the proposed deficiency prior to assessment. The SNOD is a pre-assessment document, which means the taxpayer may still have the opportunity resolve the issue before going to Tax Court.

11 See Taxpayer Bill of Rights, IRS Publication 1, *Your Rights as a Taxpayer*.

12 See IRS Publication 1, *Your Rights as a Taxpayer*.

13 TAS, *2011 IRS Nationwide Tax Forums TAS Focus Group Report: Publication 1 – Taxpayer Rights*, 26-27 (2011).

14 With Treasury's Go Direct campaign, which began in 2005, the use of inserts did not achieve desired results in terms of convincing people to transition to direct deposit. In late 2012, Treasury opted to create new inserts, many of which did not test well with focus groups. However, the campaign did find that inserts can be effective if they include a clear message and strong visual graphic tailored specifically to each target audience. Information provided by Weber Shandwick to TAS (Oct. 10, 2014) (Weber Shandwick was a contractor for Treasury and provided services for the Go Direct campaign).

15 IRC § 7803(c)(2)(D)(i)(I); H.R. CONF. REP. No. 105-599, Title I, Section D (1998); *Practices and Procedures of the Internal Revenue Service: Hearing Before the S. Comm. on Finance*, 105th Cong. 102 (1997).

16 Pub. L. 105-206, § 1102, 112 Stat. 699 (1998).

17 H.R. CONF. REP. No. 105-599, Title I, Section D (1998).

Case advocates in local TAS offices are trained to inform taxpayers of their rights and options once they receive a SNOD.<sup>18</sup> A case advocate can take any of the following steps to assist the taxpayer and relieve burden:

- Request that the IRS rescind the notice;<sup>19</sup>
- Explain that the Tax Court is a traveling court and the case will be heard in a location near the taxpayer (not Washington, DC, which is what many taxpayers think and may result in them not seeking judicial review);
- Direct the taxpayer to the Tax Court website, have the taxpayer pull up the petition, and explain what is needed without providing legal guidance; and
- Explain the small tax case (S case) process and how to get the Tax Court fee waived if the taxpayer cannot afford it.

Taxpayers' awareness of the Local Taxpayer Advocate (LTA) office within their community is even more important today, when so much of the IRS is centralized and remote from the taxpayer and the IRS is limiting its geographically-based interaction with taxpayers.<sup>20</sup> Most importantly, the local office can resolve some of the fear and mystery of the tax controversy process, especially with regard to petitioning the Tax Court. If TAS walks the taxpayer through the process, he or she may realize filing a petition is easier than expected. Therefore, by not clearly providing information about their right to contact a local office as well as accurate contact information in the notice, the IRS is preventing some taxpayers from seeking the assistance necessary to protect their rights.

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**Taxpayers' awareness of the Local Taxpayer Advocate office within their community is even more important today, when so much of the IRS is centralized and remote from the taxpayer and the IRS is limiting its geographically-based interaction with taxpayers.**

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The importance of this provision was illustrated in testimony by a public witness in the hearings leading up to RRA 98. Monsignor Lawrence Ballweg testified before the Senate Finance Committee (on September 24, 1997) about the obstacles he faced while trying to resolve issues related to a tax return he filed in his capacity as trustee. Two months after he filed the return, the IRS sent it back with a request to fill out additional forms. Shortly after responding to the request, Monsignor Ballweg received an IRS notice stating that he owed more than \$18,000 in taxes and penalties. Because he was away from home for an extended period and had no access to a copy of the filed return, he requested a copy from the IRS in order to respond. His attempts to obtain return copies were either ignored or met with inaccurate reasons as to why he did not have the authority to act as trustee. After he received a collection notice, he wrote a letter to Chairman Roth and his case was presented on CNN.

<sup>18</sup> See, e.g., *TAS Roadmap to Tax Controversy Level One* (2012).

<sup>19</sup> Rev. Proc. 98-54, 1998-43 I.R.B. 7; IRM 4.8.9.28 (Jul. 9, 2013).

<sup>20</sup> See Most Serious Problem: *IRS LOCAL PRESENCE: The Lack Of A Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *supra*.

The day after the CNN story aired, he received a call from the IRS taxpayer advocate, who resolved his case within days with no additional taxes owed.<sup>21</sup> At the hearing, Monsignor Ballweg stated:

I just wanted to say that the best kept secret of the IRS is that taxpayers have an advocate. I do not know of anybody who pays taxes who ever heard of an advocate. I would not have known about the existence of such a person until that person contacted me.<sup>22</sup>

Had the first notice to Monsignor Ballweg clearly and prominently stated that he had the right to contact a Local Taxpayer Advocate, he would have saved time, reduced frustration, and resolved his issue faster. While Monsignor Ballweg did not receive a SNOD, taxpayers who receive SNODs are often in the same position—they have sent in information to the IRS, which responds with a notice of deficiency.

In 2012, TAS reviewed a random sample of Tax Court cases in which the taxpayer petitioned the court for review of IRS disallowance of the Earned Income Tax Credit (EITC) and the IRS conceded the EITC issue *in full* without trial. The objective of the study was to determine why the IRS fails to resolve cases, including full concessions, before taxpayers are forced to file Tax Court petitions.

The findings suggest that taxpayers are willing to talk with the IRS before they petition the Tax Court and can provide acceptable supporting documentation, but do not find out how to substantiate their claims in their conversations with IRS examiners. Therefore, if the SNOD contains local TAS office contact information, the taxpayer may be able to receive the assistance necessary to submit documentation the IRS will accept, and to avoid litigation.<sup>23</sup>

### **TAS Evaluated the Inventory of SNODs and Found Significant Noncompliance with RRA 98.**

TAS reviewed the IRS inventory of current SNODs to determine compliance with the requirements in RRA 98. The findings are detailed in the following figure:

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21 *Practices and Procedures of the Internal Revenue Service: Hearing Before the S. Comm. on Finance, 105th Cong.* 102 (1997). Monsignor Ballweg publicly testified about receiving assistance from the taxpayer advocate before the Senate Finance Committee and the facts cited herein are public knowledge.

22 *Id.*

23 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 71-104 (*Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*).

FIGURE 1.23.1, Findings of TAS Evaluation of IRS Inventory of SNODS

Form number	Form title	Compliance with RRA 98?	Taxpayer Advocate Service information provided in notice
Ltr 3219 SC/CG	Notice of Deficiency – Income Tax	Yes	Includes paragraph with spaces for the LTA information
CP 3219A	Notice of Deficiency – AUR IMF	No	Includes paragraph with spaces for the LTA information. However, every notice auto-populates with TAS Austin, TX office information
CP 3219B	Notice of Deficiency – AUR BMF	Yes	Includes paragraph with spaces for the LTA information
Ltr 3219C	Notice of Deficiency – AUR (Used to remove credits if income increases)	No	Includes paragraph with spaces for the Atlanta, GA LTA information
CP 3219N	Notice of Deficiency - ASFR	No	TAS agreed to include Notice 1214 with specific addresses until IRS programming could automatically add the LTA office to the notice
Ltr 3219 SC/CG SP	Notice of Deficiency - Spanish	Yes	Paragraph included with spaces for the LTA information
Ltr 531	Notice of Deficiency (SNOD with direction on recent bankruptcy filing)	Yes	Includes paragraph with spaces for the LTA information
Ltr 531A	90-Day Letter Form 1040 or 1120 Discrepancy Adjustments	No	Contains a reference to the enclosed Notice 1214
Ltr 531B	90-Day Letter Form 5330 Excise Tax and Form 990 Tax	No	Contains a reference to the enclosed Notice 1214
Ltr 531C	Notice of Deficiency for Open Criminal Cases	No	Contains a reference to the enclosed Notice 1214
Ltr 531J	Statutory Notice of Deficiency - No Waiver Needed (Jeopardy Assessment Cases)	No	Contains a reference to the enclosed Notice 1214
Ltr 894 (CG)	Notice of Deficiency (Innocent Spouse)	Yes	Includes paragraph with spaces for the LTA information
Ltr 901 (CG)	Statutory Notice Letter (Form 1120)	Yes	Includes paragraph with spaces for the LTA information
Ltr 902 (DO)	Notice of Deficiency (Estate and Gift Taxes)	No	Contains a reference to the enclosed Notice 1214
Ltr 902 -T	Notice of Liability (Estate and Gift Taxes)	No	Contains a reference to the enclosed Notice 1214
Ltr 1384 (SC)	Notice of Deficiency (Bankruptcy)	No	Contains a reference to the enclosed Notice 1214
Ltr 3523	Notice of Determination of Worker Classification (NDWC)	No	TAS contact information is included in Publication 3953 which is sent along with Letter 3523

As shown, six out of 17 notices comply with the requirements of RRA 98, while eleven do not. We acknowledge that TAS has previously approved of the IRS's efforts to include a Notice 1214, *Helpful Contacts for Your Notice of Deficiency*, in the envelope with the SNOD.<sup>24</sup> However, this approach was

24 National Taxpayer Advocate 1998 Annual Report to Congress 6.

never intended to be a permanent solution to comply with RRA 98. The immediate focus of the first National Taxpayer Advocate in 1998 was to increase taxpayers' access to LTAs within the means available. Including Notice 1214 in the envelope with the SNOD was a feasible way to address the requirements quickly, particularly given the lead time required to program notice revisions on IRS systems. TAS has continually maintained that the IRS does not meet the requirements of RRA 98 until it places the contact information on the notice itself.<sup>25</sup> In fact, the IRS itself, in tracking post-RRA 98 actions, planned a progression from initially using the stuffer to programming systems to prepopulate the contact information on the face of the notice.<sup>26</sup>

While many SNODs have been brought into compliance since 1998, a wholesale effort is still needed to address the remaining noncompliant inventory. The IRS's tracking system LATIS shows the revision of SNODs is complete, while our own analysis reveals that many notices have not been adequately revised.<sup>27</sup> We acknowledge that the IRS regularly updates and even creates new SNODs, as need arises. Therefore, to ensure that all current SNODs accurately and consistently address this RRA 98 requirement, the IRS, in conjunction with the National Taxpayer Advocate, should develop an agreed-upon set of rules and language to appear on each SNOD.

The IRS needs to consistently populate the appropriate language and contact information onto the face of the SNOD. The inclusion of Notice 1214 as a stuffer should only be temporary as the IRS programs its systems accordingly. As the IRS revises all SNODs to comply with statutory requirements, it should program each one to auto-populate the contact information based on ZIP code to maintain consistency with how TAS aligns taxpayers to local offices.<sup>28</sup> In conjunction with these actions, the IRS should develop a method to track its progress in bringing these notices into full compliance.

## CONCLUSION

By not clearly providing information about a taxpayers' right to contact TAS, as well as placing accurate contact information on the face of the Statutory Notice of Deficiency, the IRS is preventing some taxpayers from seeking the assistance necessary to protect their rights and avoid undue burden. The IRS has made limited progress since 1998 in placing the appropriate language on less than half of the current SNODs. Taxpayers will continue to be harmed until the IRS brings the remaining notices into compliance.

25 For example, TAS had discussions with the IRS about Notice 3219N (rev. March 2014) not containing specific contact information on the face of the notice, but approved the inclusion of Notice 1214 as a stuffer until system programming changes (a Unified Work Request or UWR) could be made to the notice to automatically add the local office contact information.

26 IRS, LATIS, Action ID No. AT-2009-12065 to -12076.

27 *Id.*

28 By including local TAS office contact information on the face of the notice instead of inserting Notice 1214 as a stuffer, the IRS could use any postage savings to include the LITC contact information as a stuffer in those SNODs with deficiencies that by definition impact low income taxpayers. LITC contact information may change from year to year but the 75 LTA offices are very stable. IRS Notice 1214, *Helpful Contacts for Your Notice of Deficiency*. We are mindful that the Printing and Postage Budget Reduction Implementation Team proposed that the IRS eliminate all non-mandatory inserts in all correspondences. IRS Media & Publications, *PPBR Proposals Approved for Implementation* (Sept. 2010). Accordingly, we have made a legislative recommendation that limits the inclusion of LITC contact information as a SNOD insert for a targeted population. See Legislative Recommendation: *Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency as well as Include Low Income Taxpayer Clinic Information with the Notices Impacting that Population, infra.*

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Evaluate every SNOD to determine which ones comply with RRA 98.
2. In conjunction with the National Taxpayer Advocate, develop an agreed-upon set of rules and language to appear on each SNOD.
3. Revise all SNODs not in full compliance with RRA 98 to include the taxpayer's right to contact TAS and the name and telephone number of the local office on the face of the notice in a way that is consistent with how TAS aligns taxpayers to local offices.
4. Require all employees involved in issuing SNODs or answering incoming calls about them to take technical training developed by TAS on issues including SNOD rescission and the taxpayers' rights to file a petition in the U.S. Tax Court and to contact their LTAs.