

PREFACE: National Taxpayer Advocate's Introductory Remarks

HONORABLE MEMBERS OF CONGRESS:

The Internal Revenue Code (IRC) requires the National Taxpayer Advocate to submit two annual reports to the House Committee on Ways and Means and the Senate Committee on Finance.¹ The National Taxpayer Advocate is required to submit these reports directly to the Committees without any prior review or comment from the Commissioner of Internal Revenue, the Secretary of the Treasury, the IRS Oversight Board, any other officer or employee of the Department of the Treasury, or the Office of Management and Budget.² The first report, submitted mid-year, must identify the objectives of the Office of the Taxpayer Advocate for the fiscal year (FY) beginning in that calendar year. On the pages that follow, we identify our objectives for FY 2016, provide an overview of the recent filing season, and present certain additional information.

FY 2015 has been very challenging for the IRS and incredibly difficult for taxpayers and their representatives, particularly in the area of taxpayer service. There is no doubt that the deficiencies in taxpayer service are substantially attributable to a lack of resources. Handling more than 100 million telephone calls,³ answering ten million letters,⁴ and assisting more than five million taxpayers who visit IRS walk-in sites each year requires considerable staffing.⁵ With funding down about 17 percent on an inflation-adjusted basis since FY 2010,⁶ and with the IRS having had to implement large portions of the Patient Protection and Affordable Care Act (ACA) and the Foreign Account Tax Compliance Act (FATCA) this year without any supplemental funding, sharp declines in taxpayer service were inevitable. The IRS was forced to make some extraordinarily difficult resource-allocation decisions, and although I disagree with some of those decisions, the general success of the 2015 filing season shows the agency did a good job overall.

Yet it remains the case that millions of taxpayers were unable to reach the IRS by phone;⁷ millions did not receive a timely response (if any) to their correspondence;⁸ and many more may have had to pay a tax preparer or professional for answers to tax law questions or for assistance they could previously have obtained from the IRS for free. The impact of this increased compliance burden on taxpayers is significant, as is the loss of trust in the tax agency. For a tax system that relies on voluntary self-assessment by its taxpayers, none of this bodes well. In fact, there is a real risk that the inability of taxpayers to obtain assistance from the government, and their consequent frustration, will lead to less voluntary compliance and more enforced compliance.

Over the long term, temporary periods of limited funding can have the salutary effect of causing an organization to rethink its mission and allocate its resources more effectively. The IRS is, in fact, evaluating ways to accomplish its mission more cheaply. But from a taxpayer perspective, I am

1 IRC § 7803(c)(2)(B).

2 IRC § 7803(c)(2)(B)(iii).

3 IRS, Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot* (final week of FY 2014).

4 IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2014).

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

6 National Taxpayer Advocate 2014 Annual Report to Congress 13 (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*).

7 *Id.* at 17-8.

8 *Id.* at 18-9.

concerned its long-term approach is headed in the wrong direction. First, the IRS continues to view itself as an enforcement agency first and a service agency second. Enforcement is important, of course, but it is a question of emphasis and self-definition. Second, the IRS's vision of the future rests on a mistaken assumption that it can save dollars and maintain voluntary compliance by automating taxpayer service and issue resolution and getting out of the business of dealing with taxpayers directly in person or by phone.

The IRS Guiding Principle Should Be to Meet the Needs of Taxpayers Who Are Willing to Comply with the Tax Laws

What the IRS should do during this period of congressional distrust and resulting inadequate funding is examine every one of its underlying principles. In my view, it should transform itself as a tax agency from one that is designed around nabbing the small percentage of the population that actively evades tax to one that aims first and foremost to meet the needs of the overwhelming majority of taxpayers who are trying to comply with the tax laws. By shifting its focus, the IRS would not give up one whit of its power or any of its tools for fighting tax evasion. Indeed, it is important to the willingly compliant U.S. taxpayers that the IRS take action against those who are breaking the law. But enforcing the law against evaders should not be the organizing principle of the agency, as it is in reality today. Rather, helping taxpayers achieve and maintain voluntary compliance should be the IRS's *raison d'être*.

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It should be emphasized that more than 98 percent of all tax revenue collected by the IRS is paid voluntarily and timely. Less than two percent is collected through enforcement action.⁹ Thus, increasing enforced collection would be a hollow victory if voluntary compliance declines because of decreasing taxpayer service and the attendant loss of good will. Moreover, it makes good economic sense to facilitate voluntary compliance because voluntary compliance is far more cost effective than enforced compliance.

If the IRS were to collect ten percent less in enforcement revenue, tax revenue would decline by less than \$6 billion. If voluntary tax payments were to drop by ten percent, tax revenue would decline by more than \$300 billion. And taxpayer trust, once lost, is exceedingly difficult to regain.¹⁰

Many of our recommendations, in both this report's Areas of Focus and in the 2014 Annual Report to Congress, require the IRS to reconsider its long-held assumptions about what drives taxpayers to comply with the tax laws. When establishing policies and procedures relating to audit, collection, and penalties, IRS employees often do not avail themselves of the knowledge and research that have developed over the last few decades about the interrelationship between just procedures (procedural justice), trust, cooperation, and compliance. As noted above, the IRS continues to view itself, first and foremost, as an enforcement agency, and it thus develops its policies around the relatively small portion of the taxpayer population that is unwilling to comply with the tax laws. This focus has all sorts of consequences for the vast majority of taxpayers who are willing to comply, not the least of which is that they bear an increased burden in navigating processes designed for evaders. That is unwise, counterproductive, and expensive.

9 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), available at <http://www.gao.gov/assets/670/666863.pdf>.

10 See National Taxpayer Advocate 2014 Annual Report to Congress 7-8 (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*).

In preparing to write this preface, I reviewed the 28 reports I have submitted to Congress since 2001, when I first became the National Taxpayer Advocate. I was struck by how many of our common-sense recommendations were rejected by the IRS when first made, only to be adopted years later after much run-around, expense, and increased burden to taxpayers. I was also struck by how many of our recent recommendations the IRS continues to reject. I can only wonder if, five years from now, the IRS will adopt those recommendations. I wish we could avoid the wasted resources of the intervening five years.

Nowhere is this more evident than the IRS's handling of identity theft. TAS conducted a study of a statistically representative sample of IRS-wide identity theft cases and found that IRS processes harm victims of identity theft whose cases are complex (*i.e.*, cases that involve multiple years or multiple issues) by declining to assign one employee to interface with the victim. Without a single employee with whom to work, identity theft victims often have to call the IRS multiple times and talk with multiple employees about different aspects of their case. Equally important, no one employee is held accountable for the resolution of the case. Thus, affected taxpayers often feel like they are victimized a second time by the IRS's processes. Yet the IRS this year is once again declining to adopt what we view as the common-sense solution of allowing an identity theft victim to work with a single IRS employee to resolve his or her case.¹¹

The IRS's Long-Term Vision of Automated Taxpayer Service and Issue Resolution Ignores Taxpayers' Needs and Behavior and Increases Taxpayers' Compliance Costs

In its effort to develop a long-term strategy, the IRS is currently engaged in a servicewide evaluation of where it needs to be in five years – a “Concept of Operations” (CONOPS). The vision, as articulated in a one-page, consultant-developed graphic, envisions replacing traditional IRS employee-to-taxpayer interaction (by phone, in-person, or correspondence) with online services and expanded use of third parties (*e.g.*, software packages, preparers, and tax professionals) to be the taxpayers' interface with the IRS. It essentially eliminates any IRS-taxpayer personal interaction except in the context of enforcement actions. The consequences of this approach are clear. Taxpayers who prefer or need to speak with an IRS employee will be mostly out of luck. Pushing taxpayers to use third parties to obtain assistance the IRS heretofore has provided will increase their compliance costs.

Now, I am not a Luddite when it comes to the digital world. I am enormously proud of the Taxpayer Advocate Service's Tax Toolkit website, which is built to be every taxpayer's first stop to learn about their

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¹¹ For a discussion of the current issues involving identity theft, see Area of Focus: *The IRS Should Provide Victims of Identity Theft with a True Single Point of Contact to Help Them Resolve Their Account Problems and Obtain Their Refunds*, *infra*. For the 2014 research study and the IRS's response to TAS's recommendations, see National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 43-89 (Research Study: *Identity Theft Case Review Report: A Statistical Analysis of Identity Theft Cases Closed in June 2014*) and National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress vol. 2, *infra* (Volume 2 – *Identity Theft Case Review Report - A Statistical Analysis of Identity Theft Cases Closed in June 2014*).

rights and how to advocate for themselves if they have a tax problem.¹² In fact, since 2008, I have been calling for the IRS to create a taxpayer account that will provide the taxpayer with full information about his or her tax matters, including the ability to download wage statements and other third-party reporting into commercial software.¹³ Providing taxpayers (and their representatives) with the ability to transmit documents electronically, download transcripts (but see our discussion in the Filing Season section in this report), check on the status of return and refund processing, check on the status of correspondence and other account transactions, and receive electronic acknowledgements will provide more rapid assistance to taxpayers and eliminate the need for phone calls made by millions of taxpayers each year. Moreover, taxpayers can conduct online transactions at any hour of the day and not be dependent on the IRS's hours of business.

A well-designed taxpayer account can also provide taxpayers with alerts about relevant due dates, recently issued guidance pertaining to the taxpayer's business, and scam warnings. The ability to communicate by email and review one's account also will provide valuable service to U.S. taxpayers living outside the United States. All of these things ease taxpayers' burdens and increase taxpayers' respect for the IRS, which will have a positive effect on taxpayers' willingness to comply.

But it is wishful thinking, if not foolhardy, to expect taxpayers to rely on computer-driven systems for resolution of tax problems that, if not resolved fully, could lead to devastating financial consequences. Taxpayers, and their representatives, need the ability to *talk* with IRS employees, explain their circumstances, and make sure that the IRS understands their position. The IRS should want to *talk* with these taxpayers, because each conversation provides an opportunity for it to understand the taxpayer's facts and circumstances, recognize a situation that presents a different issue, educate the taxpayer about what is required for full compliance, and provide a full resolution to the taxpayer's problem.

This is not only critical for taxpayers, but in many cases, it is cost-effective for the IRS as well. For example, the IRS may plan to assess tax against a taxpayer simply because it hasn't heard and considered the taxpayer's side of the story. A phone call may stave off the issuance of an erroneous notice of deficiency and the consequent litigation and Appeals costs that may arise for the taxpayer and the IRS alike. Moreover, direct engagement helps instill mutual trust and cooperation, which increases taxpayers' willingness to comply.

12 <http://www.taxpayeradvocate.irs.gov>. See also *Efforts to Improve TAS Advocacy and Service to Taxpayers: TAS Develops Self-Help Options to Assist Taxpayers*, *infra*.

13 National Taxpayer Advocate 2013 Annual Report to Congress 188-96 (Most Serious Problem: *ONLINE SERVICES: The IRS's Sudden Discontinuance of the Disclosure Authorization and Electronic Account Resolution Applications Left Practitioners Without Adequate Alternatives*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67-96 (Research Study: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2012 Annual Report to Congress 251-61 (Most Serious Problem: *The IRS is Striving to Meet Taxpayers' Increasing Demand for Online Services; Yet More Needs to be Done*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*); National Taxpayer Advocate 2009 Annual Report to Congress 85-109 (Most Serious Problem: *The IRS Lacks a Servicewide e-Services Strategy*); National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*); National Taxpayer Advocate 2008 Annual Report to Congress 95-113 (Most Serious Problem: *Taxpayer Service: Bringing Service to the Taxpayer*); National Taxpayer Advocate 2004 Annual Report to Congress 101-2 (Most Serious Problem: *Electronic Return Preparation and Filing*).

But as this report and the IRS's responses to the recommendations we made in our 2014 Annual Report demonstrate, the IRS is relying increasingly on automated processes or remote, narrowly-scoped, and centralized services to provide taxpayer service and conduct enforcement. It refuses to follow congressional directives dating back to 1976 about sending clear and detailed notices to taxpayers explaining math or clerical error adjustments, thereby undermining both the taxpayer's *right to be informed* and the taxpayer's *right to appeal an IRS decision in an independent forum*.¹⁴ It is piloting the use of lower-graded, inadequately trained Automated Collection System employees to issue levies on the corpus of Thrift Savings Plans, diluting its already weak taxpayer protections in this area and not only threatening the retirement security of hundreds of thousands of taxpayers but also undermining the taxpayer's *right to privacy*, which requires the IRS to take collection actions "no more intrusive than necessary."¹⁵ It refuses to hold correspondence examination employees accountable for the decisions they make with respect to taxpayers' audits – now comprising 77 percent of all individual examinations¹⁶ – by not giving the taxpayer the choice to have his or her case worked by one Exam employee and by not requiring Exam employees to provide their names and phone numbers on manually-generated letters, as Congress required in 1998.¹⁷

The large number of taxpayers who have limited or no electronic access or skills will not be able to navigate this brave new world; the IRS is largely ignoring this reality, hoping taxpayers will grow out of it in five years' time.¹⁸ What will happen instead is that this vulnerable population will have to rely on unregulated preparers who will have unfettered access to an enormous amount of taxpayer information, increasing the risk of return preparer fraud. Moreover, a recent study found that the *general public* (a.k.a. taxpayers) "still uses nondigital

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14 National Taxpayer Advocate 2014 Annual Report to Congress 163-71 (Most Serious Problem: *MATH ERROR NOTICES: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights*); National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress vol. 2, *infra* (Most Serious Problem: *MATH ERROR NOTICES: The IRS Does Not Clearly Explain Math Error Adjustments, Making it Difficult for Taxpayers to Understand and Exercise Their Rights*).

15 See Area of Focus: *IRS Procedures for Levies on Retirement Plan Assets Create Financial Harm and Undermine Taxpayer Rights*, *infra*.

16 Internal Revenue Service Data Book, 2014 Publication 55B Washington, DC March 2015, Table 9a, available at <http://www.irs.gov/pub/irs-soi/14databk.pdf>. Seventy-six and one-half percent of individual examinations were conducted by correspondence.

17 See also National Taxpayer Advocate 2014 Annual Report to Congress 134-44 (Most Serious Problem: *CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*); National Taxpayer Advocate 2014 Annual Report to Congress 145-53 (Most Serious Problem: *AUDIT NOTICES: The IRS's Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*); National Taxpayer Advocate Fiscal Year 2016 Objectives Report to Congress vol. 2, *infra* (Most Serious Problem: *CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*) and (Most Serious Problem: *AUDIT NOTICES: The IRS's Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*).

18 See Area of Focus: *As the IRS Migrates to More Self-Service Tools and Online Services, Low Income and Other Vulnerable Taxpayer Populations May Face Greater Compliance Challenges*, *infra*. See also National Taxpayer Advocate 2014 Annual Report to Congress vol. 2, 1-26 (Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*).

channels more than digital ones, doesn't want more digital interactions with Washington, and doesn't trust the government with personal data."¹⁹ Hoping taxpayers will grow out of disinterest in digital government is misguided:

Agencies that think that Millennials are a standout digital constituency are way off the mark: Online customers ages 18 to 24 are no more likely to use digital channels than the rest of the population, they are far less likely to visit agency websites, and half of Millennials still prefer using nondigital channels.²⁰

Why would we create such a future environment, when with some strategic thinking today we could avoid it? The primary reason for this headlong rush into digital/third-party tax administration is budget-driven. The IRS has enormous responsibilities, including its role in administering the ACA and FATCA.²¹ These complex new programs are bringing more, not fewer, taxpayers into the tax system. Given this new work, the IRS is looking to replace what it views as archaic methods of dealing with taxpayers – *i.e.*, in-person meetings, assignment of cases to a specific employee, or a geographic-based presence – with what it views as modern methods – *i.e.*, digital services, batch processing, and remote, centralized employees.

The problem with this approach is that both taxpayers and the IRS need person-to-person interaction to successfully resolve most taxpayers' problems in a manner that doesn't create burden for the taxpayers and rework for the IRS. Over the years, TAS has conducted many studies of taxpayer behavior and needs, and we have made recommendations based on the findings of these studies. It is time for the IRS to pay more attention to these studies and apply the findings to its procedures and processes. It is time for the IRS to transform itself into an agency that makes its primary focus its relationship with taxpayers who are willing to comply with the laws. This population includes taxpayers who have made mistakes and aren't currently in compliance, but want to be.

Unless the IRS understands the causes of noncompliance and tailors its policies and procedures to address those underlying causes, it will just be bouncing from one enforcement action to another, doing expensive rework and not increasing voluntary compliance, and it will spend so much money that it won't have much left over for taxpayer services. The IRS can regain taxpayers' trust by learning what taxpayers need, by listening to what taxpayers say, and by starting every interaction with a taxpayer with the assumption that the taxpayer is doing his, her, or its best to comply with the complex, myriad tax laws we've created over the years. The recently adopted Taxpayer Bill of Rights can serve as a roadmap for this transformation.

19 Rick Parrish, Forrester Research, *Washington Must Work Harder to Spur the Public's Interest in Digital Government: Federal Agencies Are Spending Millions on Digital CX That Customers May Not Want* (Apr. 28, 2015).

20 *Id.* at 9.

21 See Areas of Focus: *The IRS's Administration of the Affordable Care Act Has Gone Well Overall, But Some Glitches Have Arisen and The IRS's Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*, *infra*.

This transformation requires a lot of self-reflection by the agency – it can't come from outside. I believe Congress' role here is to conduct the necessary oversight to ensure the IRS is undertaking this transformation – in its policies and procedures, in its taxpayer service initiatives, and in its examination, collection, and penalty policies and procedures. Congress should review the IRS's CONOPS, and the CONOPS should be made available for public review and comment. This is the taxpayers' tax system, after all, and taxpayers have the right to know what the IRS is planning for them. At the risk of sounding like Chicken Little, there is no time to lose. We need to do it now.

Respectfully submitted,



Nina E. Olson
30 June 2015