HONORABLE MEMBERS OF CONGRESS:

I respectfully submit for your consideration the National Taxpayer Advocate’s 2017 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

As we enter the New Year, with the IRS facing the daunting challenge of interpreting and implementing major new tax legislation, this year’s report is both a Baedeker of the current problems facing the IRS and taxpayers, and a roadmap to a better way of doing business. We have identified 21 Most Serious Problems affecting taxpayers, made 11 Legislative Recommendations, discussed the ten Most Litigated Issues and significant stand-alone decisions, and published a Volume Two containing seven Research Studies.

We are also introducing a new publication with this Report — the National Taxpayer Advocate “Purple Book.” Over the last two years, the House Ways and Means Committee has expressed interest in passing “IRS reform” legislation. The Purple Book is designed to assist the committee in its efforts, and we have aimed to make it as user friendly as possible. In it, we present a concise summary of 50 legislative recommendations that we believe will strengthen taxpayer rights and improve tax administration. Most of these recommendations have been made in detail in our prior reports, but others are presented here for the first time. Each proposal is presented in a format similar to the one used for congressional committee reports, with “Present Law,” “Reasons for Change,” and “Recommendation(s)” sections. We offer these up as an aid to Congress, as it considers taxpayer rights and IRS reform legislation in the coming year.

The IRS Funding Landscape and its “Present State”

In recent weeks, there has been considerable discussion about how the IRS has been beaten down by continuing funding cuts and about concerns the agency is stretched so thin it will not be able to properly implement tax reform. I cede to no one in my advocacy for increased IRS funding. As the National Taxpayer Advocate, I see daily the consequences of reduced funding of the IRS and the choices made by the agency in the face of these funding constraints. These impacts are real and affect everything the IRS does. Funding cuts have rendered the IRS unable to provide acceptable levels of taxpayer service, unable to upgrade its technology to improve its efficiency and effectiveness, and unable to maintain compliance programs that both promote compliance and protect taxpayer rights. “Shortcuts” have become the norm, and “shortcuts” are incompatible with high-quality tax administration. There is no doubt that the IRS needs more funding.

At the same time, limited resources cannot be used as an all-purpose excuse for mediocrity. There is not a day that goes by inside the agency when someone proposes a good idea only to be told, “We don’t have the resources.” In the private and nonprofit sectors, saying “we don’t have the resources” is the

1 National Taxpayer Advocate Purple Book: Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration, infra.
2 See Kat Lucero, Tax Administration: House Panel Aims to Unveil IRS Restructuring Bill in April, BNA DAILY TAX REPORT (Sept. 14, 2017); see also IRS Reform: Lessons Learned from the National Taxpayer Advocate: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means, 115th Cong. (2017).
beginning of the discussion, not the end. Yet with the IRS, lack of resources often has become a reflexive excuse for not doing something, or worse, for doing things “to save resources” that harm taxpayers, foster noncompliance, and undermine taxpayer and employee morale.

In this report, even as we catalog the consequences of reduced IRS funding on taxpayers and the tax system, we propose reasonable and actionable steps that can reverse this decline. If the IRS were to take these steps, many of which require no extra infusion of cash, taxpayers would receive better service, compliance efforts would be better focused, and concrete evidence would be placed before Congress that additional investments in the IRS would yield positive and meaningful results.

In my opinion, the discussion about IRS funding has largely proceeded based on false choices — either “you can’t trust the IRS to administer the tax system so don’t fund it” or “because the IRS doesn’t have enough funding, it can’t do the things it needs to do to administer the tax system.” The truth lies somewhere in between. The IRS absolutely needs more funding. It cannot answer the phone calls it currently receives, much less the phone calls it can expect to receive in light of tax reform, without adequate funding. But within the budget it currently has, there are plenty of opportunities for the IRS to demonstrate that it can do a better job of using creativity and innovation to provide taxpayer service, encourage compliance, and address noncompliance.

In one of the Public Forums I held in 2016 on Taxpayer Needs and Preferences, a practitioner commented that before the IRS focuses so much effort on its “Future State,” there is plenty the IRS can do to improve its “Present State.” This comment really struck me, because I had been feeling that the IRS, in response to budget cuts, was trying to shoe horn the taxpayers of the United States into the IRS’s picture of the Future State without paying sufficient attention to what taxpayers were needing today. In the private sector, one must do both at the same time, or one loses market share. As someone who worked much of my life with and in the nonprofit sector, I am accustomed to never having enough funding to accomplish the often life-altering tasks nonprofits undertake. But we never said, “We don’t have the resources to do this.” We found a way.

With that in mind and as the IRS moves into the 2018 Filing Season and begins to implement tax reform, this report focuses on things the IRS can do to improve customer service and taxpayer compliance with the resources it now has. The first step in this endeavor is to level-set the Present State.

- The IRS has received more than 95 million calls each year since Fiscal Year (FY) 2008. Even before the enactment of Public Law 115-97, the IRS estimated that during the 2018 filing season it would only answer about six out of ten calls from taxpayers seeking to speak to a live assistor (i.e., a 60 percent “level of service” or LOS). For the full 2018 fiscal year, the IRS estimated the LOS for calls seeking a live assistor would be below 40 percent — that is, only 4 out of 10 calls would get through to a live assistor.

- Since 2014, the IRS has only answered “basic” tax-law questions during the filing season, and it has not answered any tax-law questions beyond the April 15th filing deadline either on the toll-free telephone lines or in its Taxpayer Assistance Centers, even though more than 15 million taxpayers file returns later in the year. Thus, taxpayers who want to learn about how the tax law affects them

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5 For additional discussion, see National Taxpayer Advocate 2016 Annual Report to Congress 1-41 (Special Focus: IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration).

6 IRS, Wage & Investment (W&I), Business Performance Review 4 (Nov. 9, 2017).
are left searching about 140,000 web pages on irs.gov or turning to paid professionals. This does not bode well for taxpayers seeking information about the major tax-law changes and their impact on 2018 federal income tax returns.

- A 2016-2017 TAS survey of U.S. taxpayers who had filed at least one tax return during the preceding year showed that 41 million taxpayers had no broadband access in their homes, and 14 million have no internet access at home. Yet the IRS continues to direct taxpayers to create online accounts, even though taxpayers seeking to do so have a “pass rate” of only about 30 percent — meaning that only about 3 out of 10 taxpayers attempting to create an online account are able to do so. Results from IRS pilots of taxpayer digital communication (TDC) show that while some taxpayers find submitting documents electronically during an audit to be very useful, the TDC audits tend to have longer cycle times. Moreover, many taxpayers simply do not want to go through the process of setting up an online account. In fact, TAS’s TDC pilot included unrepresented taxpayers with Earned Income Tax Credit (EITC) or levy cases. Fewer than ten taxpayers opened accounts out of the more than 700 taxpayers who were offered the opportunity to participate in the pilot. Preliminary results from the Small Business/Self-Employed Division’s TDC audit pilot show almost 24 percent of the taxpayers who were sent an invitation to participate in the pilot attempted to create an account (2,194 out of 9,149). Of those attempts, less than half (971 out of 2,194) succeeded in opening an account. Thus, however meritorious, online accounts should not be counted on to provide significant resource savings any time soon.

- IRS staffing in key taxpayer-facing professions has declined precipitously since FY 2011. Of note is the 35 percent decline in the Stakeholder Liaison Outreach employees and Stakeholder Partnerships, Education, and Communication employees of the IRS workforce. With only about 400 employees available for direct outreach and education to taxpayers, it is questionable whether the IRS can effectively assist taxpayers in understanding their obligations under the new tax law.

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8 IRS response to TAS information request (Nov. 22, 2017).
9 For an in-depth discussion of the IRS online account and the Taxpayer Digital Communications (TDC) pilot, see Most Serious Problem: Online Accounts: The IRS’s Focus on Online Service Delivery Does Not Adequately Take into Account the Widely Divergent Needs and Preferences of the U.S. Taxpayer Population, infra.
10 The Stakeholder Liaison Outreach employees transferred to C&L on April 2, 2017.
11 Some IRS employees — although not specifically employees of an outreach and communication function — make local appearances or speeches.
The IRS has reduced its employee training budget by nearly 75 percent since FY 2009.\(^{13}\) Not only has the budget for training drastically declined, the way in which employees receive that training has shifted from face-to-face training to virtual training. In FY 2017, the IRS spent $489 per employee on training (over 0.3 percent of its budget), compared with nearly $1,450 per employee in FY 2009.\(^{14}\) The Wage and Investment (W&I) Division, which has the largest number of employees of any operating division, spends only $87 per employee per year for training.\(^{15}\)

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\(^{12}\) For fiscal years (FYS) 2011 through 2016, employee counts for Appeals Officers, Revenue Officers, Stakeholder Liaison Outreach, and SPEC Outreach are from the IRS response to the TAS fact check (Dec. 16, 2016). TAC Office figures for FYS 2011-2014 from the IRS response to the TAS fact check (Dec. 23, 2014), for FY 2015 from W&I analyst (Dec. 13, 2016), for FY 2016 from the IRS response to the TAS fact check (Dec. 20, 2016), and for FY 2017 from the IRS response to the TAS fact check (Nov. 3, 2017). The remaining data is obtained from a TAS query of non-supervisory positions and IRS Offices from the IRS Human Resources Reporting Center, Position Report by Employee Listing for the ending pay period FY 2011 to FY 2017. TAC Service representatives are non-supervisory employees in the 501 job series. Different from the data provided by the IRS that we published last year, Revenue Agent (RA) counts now only include field RAs (non-supervisory) in the TE/GE, SB/SE, and LB&I operating divisions. The RA data published last year from the IRS response to TAS fact check (Dec. 16, 2016) included duplicate counts of RAs in the Appeals function; and also included non-field RAs in the Whistleblower Office and in TAS. The counts of TAS caseworkers are from the Integrated Financial System. For 2017, the IRS responded that C&L had 105 employees assigned to outreach activities. However, the IRS response to the TAS fact check stated that these numbers only account for Small Business/Self-Employed (SB/SE) Stakeholder Liaison (SL) employees transferred to C&L on April 2, 2017. Therefore, we do not have details regarding any additional outreach employees. IRS response to TAS fact check (Nov. 20, 2017).

\(^{13}\) IRS response to TAS information requests (Nov. 22, 2013 and Nov. 7, 2017); IRS response to TAS fact check (Dec. 15, 2017). While the budget for training has increased by approximately $17 million since a low point of approximately $22.6 million in fiscal year (FY) 2013, the reduction from previous years of nearly $115 million spent on training is drastic.


IRS provides only 19 hours of training per employee in at least one key job series, which includes nearly five hours of mandatory briefings, leaving only 14 hours of substantive training.\textsuperscript{16}

The IRS estimates that it will need about $495 million in FYs 2018 and 2019 to implement Public Law 115-97, including programming and systems updates, answering taxpayer phone calls, drafting and publishing new forms and publications, revising regulations and issuing other guidance, training employees on the new law and guidance, and developing the systems capacity to verify compliance with new eligibility and documentation requirements. The IRS has identified 131 filing season systems that will be impacted by the new legislative provisions which, among other things, include incorporating new individual and business tax rates, gradual inflation indexing changes for deductions and credits, threshold changes repeal, removing existing credits from systems, and updating fraud detection filters.

Following enactment of the last major tax reform legislation, the Tax Reform Act of 1986,\textsuperscript{17} the IRS made changes to 162 existing forms, developed 48 new forms, and created 13 new publications. Call volume increased by 14 percent, and the IRS hired an additional 1,300 staff, increased phone capacity by 30 percent, and expanded hours and phone service to Saturdays. There was a two percent increase in tax returns that had to be corrected in processing. The IRS’s recent experience implementing the Patient Protection and Affordable Care Act\textsuperscript{18} suggests the additional work required by the Tax Reform Act of 1986 may be a reasonable predictor. After the passage of the ACA, calls and correspondence from taxpayers increased by eight percent from FY 2010 to 2011, and then increased by another 18 percent the following year.\textsuperscript{19} However, the magnitude of taxpayer confusion and the number of inquiries a new law will generate are difficult to predict and can vary depending on the provisions in the law. After Congress authorized Economic Stimulus Payments in 2008, for example, the IRS was deluged with taxpayer telephone calls. Incoming calls on the Accounts Management telephone lines rose from about 66 million in FY 2007 to about 151 million in FY 2008 — an increase of over 125 percent.

**Rebuilding the IRS Customer Service Environment**

As the discussion above clearly demonstrates, the IRS needs more employees simply to answer the volume of phone calls and correspondence it annually receives. But because the IRS has focused its technology efforts on creating an online account — an important development and long overdue — it has not kept up with telephone technology or the approaches the private sector has adopted to deliver better customer service.\textsuperscript{20} Instead, it has cherry-picked the practices that suit its own goals — to limit person-to-person contact in favor of automated and digital applications. It is doing this from a pure short-term cost analysis. But what private sector practices show — as outlined in our Most Serious Problem and Literature Review on telephone assistance\textsuperscript{21} — is that customers have multiple needs and choose the


\textsuperscript{17} Pub. L. No. 99-514, 100 Stat. 2085 (1986).


\textsuperscript{19} IRS, TCJA Preliminary Implementation Cost Estimates (Nov. 2017) (document on file with the National Taxpayer Advocate).

\textsuperscript{20} For example, the IRS does not have the capability to offer customer callback or scheduled call-back options.

service option that best serves those needs. Customers (taxpayers) are smart in that way, but the IRS service strategy seeks to override taxpayers’ own assessment of how they need to receive assistance and replace it with the IRS’s belief that it knows better than the taxpayers themselves.

What would it take for the IRS to provide 21st century customer service? First, it must acknowledge what the private sector clearly knows: If you don’t serve customers in the way they want and need to be served, they will look somewhere else. Of course, the IRS, as the only federal tax agency in the United States, has a monopoly on tax administration. On the surface, it appears “customers” (taxpayers) don’t have a choice about seeking another tax agency to work with — there are no competitors to which they can move their “business.” In fact, however, there is a competitor, and it is the lure of noncompliance. If the IRS isn’t going to provide you the assistance you need in the manner you need it, then why bother complying with the tax laws? Yes, taxpayers know there may be consequences for blatant noncompliance, but if and when the opportunity presents itself for a taxpayer not to comply in subtle ways that are hard to detect (e.g., reporting cash-economy income), the taxpayer may be more likely to take the opportunity, because there is no “brand loyalty” to the IRS and tax compliance. Simply put, the IRS hasn’t earned taxpayer loyalty.

Alternatively, taxpayers seek tax assistance from a variety of tax sources — which may be licensed professionals (e.g., attorneys, certified public accountants, or Enrolled Agents) or unregulated persons or just random internet sites. As we discuss in the Purple Book, the quality of the assistance varies wildly. And it is not free. Thus, because the IRS doesn’t provide top quality service to the average taxpayer, he or she must pay for it. This increases the individual burden of tax compliance.

So how can we arrest this sad state of affairs and turn the IRS and taxpayers’ fortunes around? As a first step, the IRS should do a better job of following the priorities its appropriators have repeatedly set. For example, the Appropriations Committees have pushed back against the IRS’s plans to transition taxpayers to online services, directing the agency to embrace an omnichannel customer service strategy and provide

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22 An omnichannel service environment “ensures the service level, responsiveness, and quality of service received on individual channels and across channels would be equally high.” Aspect, What is an Omnichannel Experience?, https://www.aspect.com/glossary/what-is-omni-channel-customer-service-experience.

23 National Taxpayer Advocate Purple Book: Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration: Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers, infra.
it with the specifics about what it would take to deliver this approach. To date, the IRS has not done so. If the IRS availed itself of this opportunity and set forth a plan — with specifics — that reflected an acceptance and understanding that taxpayers need ongoing access to all customer service methods — online, phone, in-person — instead of promoting the fiction of a Future State where almost everything is done online, the IRS would probably gain more credibility with the Appropriations Committees and would be more likely to receive additional funding. At the risk of vast understatement, a first step toward getting additional funding is complying with what your appropriators ask you to do.

Restoring the Taxpayer Compliance Environment
In addition to concerns about the present state of customer service, there are also concerns about declining audit rates. As noted above, the number of field revenue agents has declined from 8,652 in year FY 2011 to 8,502 in FY 2017. But as we discuss in our Most Serious Problem on audit rates, this is only part of the story. In fact, the IRS underreports much of its compliance activity, because it has shifted its resources into automated, centralized, or correspondence initiatives. When you count those initiatives, the individual “compliance contact” rate for FY 2016 rises from 7/10ths of 1 percent to 6.2 percent.

But this is not just about numbers — it is about the way the IRS intends to do its compliance work in the future. Certainly, using correspondence to correct simple math or clerical errors makes sense — although no one would say IRS math error notices are a model of clarity. But many tax return errors are attributable to the complexity of either the tax laws or taxpayers’ lives. For example, while one might think it is easy to determine whether you are eligible to claim your child for purposes of the dependency exemption, the child tax credit, or the Earned Income Tax Credit, these provisions are highly complex, and people’s family structures are increasingly diverse. Further, no matter how a business entity is organized, determining the deductibility of “ordinary and necessary” trade or business expenses is no easy

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25 For a legislative recommendation about the IRS’s “math error” authority, see National Taxpayer Advocate Purple Book: Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration: Continue to Limit the IRS’s Use of “Math Error Authority” to Clear-Cut Categories Specified by Statute, infra.

26 The Committee directs the IRS to conduct a study on the impact of closing a Taxpayer Assistance Center and the adverse effects it has on taxpayers’ ability to interact with the IRS. Should the IRS choose to close a TAC location, the Committee directs the IRS to conduct a study on the impact of closing a TAC location and the status of any proposed alternatives to fully staffed TACs (such as virtual customer service sites).
matter — as Supreme Court Justice Cardozo noted, “life in all its fullness must supply the answer to the riddle.”

In these instances, correspondence and automated audits just don’t work. There needs to be person-to-person communication, and one auditor needs to be assigned to the taxpayer’s case. This is essential if one looks at audits as an educational tool foremost and a revenue protection tool secondarily. The goal of any audit should be for the tax agency to understand the specific facts and circumstances of the taxpayer’s situation and apply the law in light of those facts and circumstances and for the taxpayer to understand what he did incorrectly and how to proceed going forward in compliance with the law. The IRS can’t do that without personal interaction in the context of family status or small business or sole proprietorship audits. And why you would want to avoid personal interaction with taxpayers is beyond me; this represents a missed educational opportunity and a waste of those precious audit resources.

In fact, a recent study of attitudes of sole proprietors and other taxpayers toward the tax system, included in this Report, found that only 38.8 percent of sole proprietors subject to a correspondence audit recalled they had had such an audit (compared to 67 percent for field audits and 73.7 percent for office audits). This finding indicates there is not much of a “learning opportunity” with correspondence audits. Moreover, sole proprietors who had correspondence audits reported relatively low perceived levels of procedural, informational, interpersonal, and distributive justice, and feel less protected by the IRS. If taxpayer attitudes towards the tax system affect their willingness to comply with the tax laws, as I believe they do, then these findings undermine the IRS’s position that correspondence audits are efficient and effective.

Problems of the IRS’s Own Making

In this report, many of our Most Serious Problems are a roadmap to the way in which the IRS’s implementation of congressional mandates as well as its own “Future State” vision are either actively harming taxpayers or are creating re-work for itself, thereby wasting resources. A few of them merit mention here.

Private Debt Collection: Whatever one might think about Congress’s mandate that the IRS use private debt collectors to make a dent in the nearly $400 billion owed, everyone can agree that if the program is going forward, we want it administered in a way that is “no more intrusive than necessary.” In this Report, however, we show the IRS’s implementation of this program unnecessarily harms taxpayers and constitutes an end-run around the significant taxpayer rights protections that Congress has enacted in the collection arena.

To ensure the IRS does not collect a tax debt if doing so would leave a taxpayer without enough money to meet his or her basic living expenses, Congress required the IRS to “develop and publish schedules of national and local allowances” that ensure taxpayers “have an adequate means to provide for basic

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30 For an in-depth discussion of Private Debt Collection, see Most Serious Problem: Private Debt Collection: The IRS’s Private Debt Collection Program Is Not Generating Net Revenues, Appears to Have Been Implemented Inconsistently with the Law, and Burdens Taxpayers Experiencing Economic Hardship, infra.
31 The Taxpayer Bill of Rights includes the right to privacy, which the IRS describes as follows: “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.” IRS Pub. 1, Your Rights as a Taxpayer (Sept. 2017).
living expenses."\textsuperscript{32} These Allowable Expense Standards, or ALEs, are a key component of the IRS's determination of a taxpayer's ability to pay a tax debt. If the IRS determines a taxpayer's income is below the appropriate ALE amount, it will classify that taxpayer as "Currently Not Collectible — Hardship" and generally not levy or take enforced collection action.

While there is no Internal Revenue Code definition of "low income," 250 percent of federal poverty level has been widely used as a proxy for "low income" by Congress in setting eligibility for \textit{pro bono} representation by Low Income Taxpayer Clinics\textsuperscript{33} and by the IRS in setting a carve-out level for Social Security recipients under the automated Federal Payment Levy Program. Yet, although the IRS has the legal authority and the capability to do so, the IRS has refused to screen out taxpayers whose incomes are so low that they would be eligible for "Currently Not Collectible-Hardship" status and, by law,\textsuperscript{34} not subject to a levy on salary or wages.

IRS data bear out the impact of these decisions. Approximately 2,100 taxpayers entered into installment agreements while their debts were assigned to private collection agencies (PCAs), made payments on which the PCAs were paid commissions, and have filed recent returns.\textsuperscript{35} According to these taxpayers' returns, more than 45 percent had income that was less than their ALEs.\textsuperscript{36} Thus, these taxpayers could not afford to pay their basic living expenses under the installment agreements organized by the PCAs.

Moreover, of the 4,905 taxpayers who made payments after their debts were assigned to a private collection agency, 4,141 had filed recent returns as of September 28, 2017.\textsuperscript{37} The returns filed by the 4,141 taxpayers show:

- 19 percent had incomes below the federal poverty level; median income for these taxpayers was $6,386;\textsuperscript{38} and
- 25 percent had incomes above the federal poverty level but below 250 percent of the federal poverty level; median income for these taxpayers was $23,096.\textsuperscript{39}

It is extremely likely that these taxpayers do not have the ability to meet their basic living expenses and would be placed in CNC-hardship status if their accounts were handled by the IRS. By not screening out these taxpayers from going to PCAs — who do not conduct financial analysis — the IRS is allowing collection against taxpayers that Congress explicitly and specifically sought to protect.

No one is making the IRS make these bad decisions. The harm to these taxpayers is something IRS leadership consciously decided to do despite my personal efforts, and those of my organization, to stop it.

\begin{itemize}
\item \textsuperscript{32} IRC § 7122(d)(2)(A).
\item \textsuperscript{33} See IRC § 7526(b)(1)(B)(i).
\item \textsuperscript{34} IRC § 6343 requires the IRS to release a levy in certain circumstances, including when the taxpayer and the IRS agree that the tax is not collectible. See IRC § 6343(e).
\item \textsuperscript{35} \textit{Id.}
\item \textsuperscript{36} As discussed below, for purposes of administering the IRS’s automatic levy program, the Federal Payment Levy Program (FPLP), the IRS adopted 250 percent of the federal poverty level as a measure that serves as a proxy for economic hardship.
\end{itemize}
Form 1023-EZ: In 2014, in response to 18-month cycle times for applicants for tax-exempt status under IRC § 501(c)(3) to receive determination letters from the IRS, the IRS introduced a radically shortened Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. The IRS has touted this initiative as a poster child of its “Future State” vision — claiming that it has reduced taxpayer burden, resource demands, and cycle time for tens of thousands of new tax-exempt organizations. In reality, what this initiative has done is allowed thousands of organizations that do not meet the statutory requirements for exemption to operate unchecked and uninformed. Specifically, the new procedures do not require these applicants to submit their articles of incorporation or bylaws to ensure they are properly organized and have adopted the appropriate charitable purpose clause as well as protections against misuse of funds.

As a result, TAS research studies have shown that for the last three years, between 26 and 42 percent of approved entities filing Form 1023-EZ did not meet the organizational test for qualification as an IRC § 501(c)(3) organization. This finding is even more stunning when you consider that Form 1023-EZ applicants now outnumber applications on the full Form 1023. Improper grants of tax-exempt status come at a huge cost to all U.S. taxpayers, since these entities are receiving funds tax-free and donors are getting tax deductions for charitable contributions. Yet the IRS steadfastly refuses to either check the online registers of articles of incorporation or to require organizations to submit their organizing documents with their application. Instead of addressing compliance concerns upfront when the organization is applying for recognition of its exempt status, the IRS says it will audit itself out of a problem entirely of its own making. And it is not doing that either, as the IRS audits fewer than one percent of tax-exempt entities every year. If this program is the apotheosis of the Future State vision, well, no wonder Congress and other stakeholders have concerns about the agency’s direction.

Passport Denial/Revocation: In early 2018, the IRS will begin implementing the congressionally mandated program that will lead to denial of passports to U.S. citizens who owe more than $51,000 in aggregate federal tax debt and meet certain other criteria. The IRS Office of Chief Counsel has opined that the IRS has significant flexibility in administering this program, with even more discretion to create exclusions under this program than under the PDC program. Yet as we discuss in this Report, the way the IRS is administering the program arguably violates constitutional due process protections by failing to give adequate notice to the affected taxpayers of the denial and provide them sufficient time after that notice to come in and correct the situation before the harm (passport denial) occurs.

The IRS procedures most certainly violate the right to a fair and just tax system, which the IRS itself says includes “the right to expect the tax system to consider facts and circumstances that might affect [taxpayers’] underlying liabilities, ability to pay, or ability to provide information timely” and “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.”\textsuperscript{43} Instead, the IRS has categorically refused to exclude those taxpayers who currently have cases in the Taxpayer Advocate Service. As of October 1, 2017, there were about 800 taxpayers who owe balances above $50,000 in the aggregate, do not meet a statutory or discretionary exclusion criteria, and were actively working with TAS to resolve their tax issues. Of the TAS cases with balances due over $50,000 that closed in FY 2017, more than 75 percent involve either exam or collection issues, and TAS closed 70 percent of these cases with full or partial relief. The IRS has the capability and authority to exclude these cases from the Passport program, yet it has refused to do so, for the “reason” that it would be treating these taxpayers differently from others. This is bizarre reasoning, since by statute, a taxpayer whose case is accepted in TAS has a “significant hardship” and TAS cases are treated differently as a matter of law, presumably because Congress believed taxpayers who approach TAS to try to resolve their problems deserve to be protected from most adverse actions while their cases are pending. This IRS decision also makes little sense from the standpoint of resource savings, because by certifying these cases to the Department of State, the IRS is creating additional work for TAS and for itself. Specifically, once TAS achieves a resolution of this case (which it usually does), we will also have to get the taxpayer “decertified.” To avoid this needless waste of resources, I will be issuing Taxpayer Assistance Orders\textsuperscript{44} (TAOs) before the program commences with respect to every taxpayer with an assessed, unpaid federal tax debt over $51,000 who has an open case in TAS and who does not otherwise meet an exception or exclusion from certification; the TAOs will order the IRS to not make the referral to the Department of State.

\textbf{Conclusion}

I realize that after this high-speed road trip through the IRS Present and Future State, readers may come away somewhat dispirited. However, I hope that readers will see, notwithstanding all the challenges the IRS faces, that there are solutions to these problems. Some of those solutions require more funding — for example, the IRS simply needs more staff to answer telephone calls and conduct field outreach and education, audit, appeals, and collection activities. But for each of the problems we’ve identified and discussed in the pages of this Report, there are recommendations that do not require substantial monetary investment to achieve. What these recommendations require is a willingness on the part of IRS leadership to look at tax administration through the eyes of the taxpayer, to be open to new approaches, and to cultivate creativity. Challenges notwithstanding, with strong leadership of the IRS and support from Congress, this can happen. It won’t be easy, but the taxpayers of the United States deserve a better functioning IRS that understands and meets their needs, even as it ensures that all taxpayers comply with the tax laws.

Respectfully submitted,

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Nina E. Olson
National Taxpayer Advocate
31 December 2017

\textsuperscript{43} IRS Pub. 1, \textit{Your Rights as a Taxpayer} (Sept. 2017).
\textsuperscript{44} See IRC § 7811.
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