

MSP
#9**COMBINATION LETTERS: Combination Letters May Confuse Taxpayers and Undermine Taxpayer Rights****RESPONSIBLE OFFICIALS**

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TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

PROBLEM

The IRS uses the Combination Letter, which combines the Initial Contact Letter and the 30-Day Letter, in hundreds of thousands of correspondence audits.² In fiscal years (FYs) 2015-2019, the IRS used the Combination Letter in approximately 16 percent, or about 500,000, correspondence audits.³ When the IRS combines two letters with very different functions, taxpayers may experience:

- Insufficient time to provide necessary documentation and resolve questionable items;
- Confusion because the inclusion of the audit report in the initial contact gives the appearance that the result of the audit is a foregone conclusion;
- Insufficient understanding of their right to appeal and the related timeframe; and
- A lower likelihood of responding to the letter as compared to taxpayers who received two separate letters.⁴

Despite the problems Combination Letters create for taxpayers, the IRS Wage & Investment (W&I) Division has plans to expand its use of the letters to additional issues.⁵

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 Audits conducted through the mail are also referred to as “correspondence” audits.

3 In this Most Serious Problem (MSP), we focus solely on Combination Letters sent by the IRS Wage and Investment (W&I) and Small Business/Self-Employed (SB/SE) divisions. All data and procedural analysis referenced in this MSP is based on W&I and SB/SE data and procedures. Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams started after September 30, 2014. This is an estimate based on project codes where a Combination Letter could have been sent. IRS response to TAS fact check (Nov. 25, 2019).

4 See Figure 1.9.2, *infra*. IRS response to TAS fact check (Nov. 25, 2019).

5 IRS response to TAS information request (July 2, 2019) (W&I is considering expanding use of the Combination Letter to “[Premium Tax Credit] within project code 1300 for specific error codes” and “Unallowable Project Code 0000 with Source Code 03 (for those items that are truly unallowable by law).”

IMPACT ON TAXPAYERS

The Combination Letter combines the Initial Contact Letter and the 30-Day Letter into a single letter.⁶ The use of the Combination Letter is usually limited to correspondence audits, the most common type of IRS examination.⁷ While the IRS generally uses a two-letter process for the majority of its examinations, it began using Combination Letters in 1999 to shorten the time required for correspondence exams and to maximize employee resources.⁸ Prior to 2006, the Combination Letter was most often used in examinations of the Earned Income Tax Credit (EITC).⁹ In response to the National Taxpayer Advocate's concerns surrounding the IRS's use of the Combination Letter,¹⁰ the IRS stopped using the Combination Letter in EITC exams.¹¹ However, the Combination Letter still impacted approximately 16 percent of the three million correspondence examinations opened by the IRS W&I and Small Business/Self-Employed (SB/SE) divisions between FYs 2015-2019.¹²

The IRS Uses Combination Letters to Fast-Track Certain Examinations, Shortening the Timeframe for Taxpayers to Resolve Problems When Compared to the Two-Letter Process

In the two-letter process, the IRS mails an Initial Contact Letter to the taxpayer at the beginning of the examination to inform him or her that the IRS has selected his or her return for examination, to specify the items under examination, and to request documentation to verify the items the IRS is examining.¹³ This letter allows taxpayers 30 days to provide support for the examined items.¹⁴ The 30-Day Letter is sent to a taxpayer to communicate the audit adjustments after the IRS has considered any information that the taxpayer provided.¹⁵ This letter gives taxpayers 30 days to provide additional documentation, rebut the audit adjustments, or request an appeal of the audit adjustments prior to paying any additional tax due.

The 30-Day Letter is critical because it is the only way the taxpayer can appeal the IRS's determination in an independent forum prior to going to Tax Court. For many taxpayers, it is the only appeal right they will get because many cannot afford legal representation, or they find the idea of going to court intimidating.

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- 6 See, e.g., Letter 566B. See also National Taxpayer Advocate 2003 Annual Report to Congress 87 (Most Serious Problem: *Combination Letter*).
- 7 In FY 2018, the IRS conducted 741,400 audits via correspondence, and 74.8 percent of all audits conducted were via correspondence. The remaining 25.2 percent were conducted in the field by revenue agents, tax compliance officers, tax examiners, and revenue officer examiners. IRS Pub. 55B, IRS Databook 2018, 23 (May 2019) (Table 9a).
- 8 See National Taxpayer Advocate 2003 Annual Report to Congress 87 (Most Serious Problem: *Combination Letter*).
- 9 At the time, EITC examinations made up approximately three quarters of all correspondence audits. In FY 2001, Correspondence Examination units on IRS campuses conducted 401,448 EITC examinations, 9,624 non-filer examinations, and 129,830 other examinations for a total of 540,902 examinations. See National Taxpayer Advocate 2003 Annual Report to Congress 89 (Most Serious Problem: *Combination Letter*).
- 10 See National Taxpayer Advocate 2003 Annual Report to Congress 87 (Most Serious Problem: *Combination Letter*).
- 11 *Id.*; IRS response to TAS information request (July 2, 2019). See also Internal Revenue Manual (IRM) 4.19.1.5.2, RPS Examination Process (Jan. 1, 2006).
- 12 Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams started after September 30, 2014. This is an estimate based on project codes where a Combination Letter could have been sent. IRS response to TAS fact check (Nov. 25, 2019).
- 13 IRM 4.19.13., Initial Contact (Mar. 10, 2016). See, e.g., Letter 566; Letter 566D. See also National Taxpayer Advocate 2008 Annual Report to Congress 243 (Most Serious Problem: *The IRS Correspondence Examination Program Promotes Premature Notices, Case Closures, and Assessments*).
- 14 See, e.g., Letter 566D.
- 15 IRM 4.19.13.12, No Response and Unagreed Cases (Feb. 9, 2018). See also Letter 525 (sent as 30-Day Letter and also as a Combination Letter).

In the Combination Letter process, taxpayers receive only one letter that both informs them that their tax return is under audit and serves as a letter transmitting the audit report reflecting the audit outcome should the taxpayer fail to substantiate the items under examination. The letter date not only starts the 30-day timeframe in which the taxpayer must respond and provide substantiation for examined items, it also starts the clock on the taxpayer's 30-day window to request an appeal. While the Combination Letter refers the taxpayer to IRS Publication 3498-A, *The Examination Process (Audits by Mail)*, for more information on the audit process, including appeal rights, it does not fully discuss the taxpayer's options within the body of the letter.¹⁶

The IRS sends Combination Letters for examinations where the taxpayers were previously contacted by the IRS and subsequently selected for examination.¹⁷ The IRS also uses Combination Letters when it “can clearly determine the taxpayers are not entitled to the credits or there is a clear mathematical computation”¹⁸ or “if the item is clearly unallowable.”¹⁹ In essence, the IRS is fast-tracking certain correspondence exams where it believes taxpayers are definitely in the wrong.

Because the IRS cannot provide data showing the number of Combination Letters it sends in a given year or show the outcome of cases in which it used the Combination Letter,²⁰ the IRS is unable to track data or analyze the effects of using Combination Letters on the IRS or taxpayers.²¹ To understand when the IRS uses Combination Letters, Figure 1.9.1 details the issues for which such letters might be used. By reviewing the examination results for these issues, we have estimated the impact of the Combination Letter by comparing these examination results to other correspondence examination results as shown in Figures 1.9.2 and 1.9.3.

16 See, e.g. Letter 566B; see also National Taxpayer Advocate 2008 Annual Report to Congress 243 (Most Serious Problem: *The IRS Correspondence Examination Program Promotes Premature Notices, Case Closures, and Assessments*).

17 IRS response to TAS information request (July 2, 2019).

18 *Id.* (this is the procedure for W&I).

19 *Id.* (this is the procedure for SB/SE).

20 *Id.*

21 See IRS response to TAS information request (July 2, 2019). Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams started. Estimates are based on project codes where a Combination Letter could have been sent. IRS response to TAS fact check (Nov. 25, 2019).

FIGURE 1.9.1, Project Codes Where a Combination Letter May Be Issued²²

Project Code	Issue Description	Combination Letter Number
0	Unallowable Program	525
44	Erroneous Refunds	566B
59	Related Pickup Non-EITC Duplicate TIN	566B
124	SE Tax	718
125	Math Error Non-EITC	566B
133	Criminal Investigation - CI - Non-EITC Referral	566B
277	Substitute for Returns (SFR)	1862
385	Criminal Investigation - Non-EITC Credits	566B
394	Child & Dependent Care - Child turned 13 the first half of the year	566B
400	Child & Dependent Care - Child over 12 the entire year	566B
406	Hope Education Credit Greater Than 2 years for same student	566B
420	General Business Credit, No Business Indicators	566S*
505	Health Coverage Tax Credit	525
628	Child & Dependent Care - Duplicate Dependent for Child Tax Credit, Child and Dependent Care Credit or Education Credit	566B
631	Alternative Minimum Tax	2194
1521	Automated Underreporter With Greater Than 100 Information Returns	2625C, 2626C, Computer Paragraph Notice (CP) 2000 or CP 2501

²² These are the project codes that the IRS informed us a Combination Letter may be issued, as well as additional project codes we found independently in the IRM. IRS response to TAS information request (July 2, 2019) (identifying that Combination Letters may be issued in project codes 0000, 0124, 0394, 0400, 0420, 0631, and 1521). Please note that the IRS identified project code 0420 as one that the IRS used Combination Letters for. However, the IRS did not provide an associated Combination Letter with this project code, nor could TAS find one, so we included in Figure 1.9.1 Letter 566S, the initial contact letter associated with the 0420 project code. See also IRM 4.19.15.17(8), Erroneous Refunds (Nov. 4, 2019) (0044); IRM 4.19.15.11.1(2), Initial Contact (Dec. 1, 2017) (0059); IRM 4.19.15.10(4), Math/Clerical Error (Dec. 1, 2017) (0125); IRM 4.19.15.3(4), Education Tax Benefits - General Requirements and Exam Programs (Nov. 4, 2019) (0406, beginning on March 14, 2016, the IRS no longer used Combination Letters for this project code); IRM 4.19.15.2(6), Child and Dependent Care Credit (Nov. 4, 2019) (0628). The IRS informed us that a Combination Letter was no longer use in project code 0000 cases after November 1, 2016. IRS response to TAS follow-up request (Nov. 25, 2019).

Taxpayers May Miss Deadlines Because the Combination Letter Reduces Response Time and Taxpayer Contacts

The IRS gives taxpayers who receive both an Initial Contact Letter and a 30-Day Letter two separate opportunities to provide documentation — one 30-day period upon receiving the initial contact requesting documentation and another 30-day period upon receiving the audit report at the conclusion of the exam.²³ The Combination Letter can cut the time taxpayers have to provide documentation to a single 30-day period.²⁴ This compressed timeframe may be insufficient for taxpayers to properly gather and provide the necessary documentation needed to resolve any questionable items.

Taxpayers may be so focused on the news that they are under audit and the tasks necessary to gather the requested documents that they may overlook that the 30-day period provided by the Combination Letter is also their opportunity to request an Appeals conference. Taxpayers will likely believe that their exam is not yet final and will not realize that, even if they provide supporting information that the IRS deems insufficient, the IRS may not provide the taxpayer additional time beyond the 30-day period to request an Appeals conference,²⁵ thereby effectively losing the *right to appeal in an independent forum*.

The Combination Letter Gives the Appearance the Audit Result Is a Foregone Conclusion, Causing Taxpayer Confusion and Failure to Respond

Enclosed with the Combination Letter is an audit report showing the items in question as disallowed. However, neither the audit report²⁶ nor the Combination Letter indicate that the adjustments on the enclosed audit report are tentative. Additionally, one Combination Letter begins, “If you don’t agree with the proposed changes...”²⁷ This can give the appearance that the IRS has already determined the outcome of the audit and any input from the taxpayer would be superfluous. Data shows that the non-response rate for taxpayers identified as being potentially subject to the issuance of the Combination Letter is, on average, 29 percentage points higher²⁸ than taxpayers who received the Initial Contact and 30-Day letters. (See Figure 1.9.2)

23 See, e.g., Letters 566D & 525. See also National Taxpayer Advocate 2008 Annual Report to Congress 243 (Most Serious Problem: *The IRS Correspondence Examination Program Promotes Premature Notices, Case Closures, and Assessments*).

24 In some circumstances the taxpayer can have longer than 30 days to respond, depending on the IRS response. The IRS also generally gives 15 days for mail processing, though taxpayers are not made aware of this “extra” time. W&I response to TAS fact check (Nov. 14, 2019). The time given, however, is still shorter than the 60 days from the two-letter process. IRM 4.19.13.10.1, Taxpayer Responses – Additional Information Needed (Apr. 3, 2017), instructs examiners to update cases to status code 25, thereby suspending the case for 30 days prior to the issuance of the Statutory Notice of Deficiency. See also IRM 4.19.10.1.5.2, Standard Suspense Periods for Correspondence Examination (Dec. 8, 2017). Taxpayers are not informed of this suspension period. Examiners typically give taxpayers a response date of 15 days from the date the L692 was sent, giving taxpayers the impression that the response date is the final date they can submit information for the audit.

25 IRM 4.19.13.10.1, Taxpayer Responses – Additional Information Needed (Apr. 3, 2017) (instructing examiners who receive insufficient information from a taxpayer to: 1) attempt calling the taxpayer to explain why the information sent is not sufficient and what is still needed, no Letter 692 is sent, or 2) send Letter 692 with an explanation of why the information received is insufficient and what information is still needed if attempt to reach taxpayer was unsuccessful).

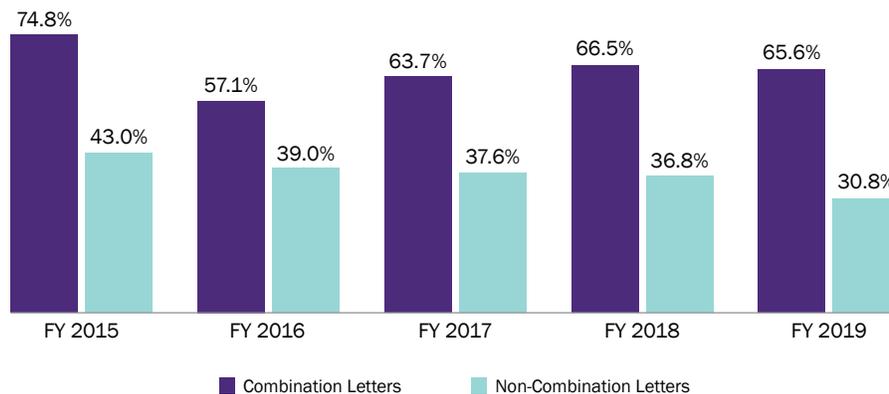
26 Usually Form 4549, Report of Income Tax Examination Changes.

27 See, e.g., Letter 566B.

28 The average non-response rate between FYs 2015-2019 for W&I and SB/SE correspondence examinations is 43 percent. IRS response to TAS fact check (Nov. 25, 2019). The non-response rate for W&I and SB/SE correspondence cases subject to combination letter procedures is 67 percent. IRS response to TAS fact check (Nov. 25, 2019).

FIGURE 1.9.2²⁹

**Comparison of Non-Response Closure Rates for Correspondence Audits
by Type of Initial Contact Letter, FYs 2015-2019**



Unfortunately, this failure to respond to the IRS may cause taxpayers to pay more tax than required, jeopardizing their *right to pay no more than the correct amount of tax*. Alternatively, the Combination Letter may cause taxpayers to make an appeal prematurely, thinking they have no choice but to appeal something the IRS has already decided against them. Since a taxpayer cannot appeal without having provided substantive support, Appeals will almost always send these cases back, wasting both the taxpayer's time and the IRS's resources.

Considering the confusion the Combination Letter may cause, a taxpayer's *right to a fair and just tax system* is inadvertently violated by the IRS's use of this letter. Furthermore, when taxpayers decline to participate in an examination, future compliance is impacted because the IRS misses an opportunity to educate these taxpayers during an audit about reoccurring errors they may be making. Despite these risks to taxpayers' rights, the IRS has not conducted research studies on the effect design (or redesign) of Combination Letters has on taxpayer responsiveness.³⁰

²⁹ Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams. Estimates are based on project codes where a Combination Letter could have been sent for audits starting after September 30, 2014. IRS response to TAS fact check (Nov. 25, 2019).

³⁰ Neither W&I nor SB/SE have conducted behavioral research studies on these Combination Letter issues. IRS response to TAS information request (July 2, 2019). The IRS Research, Applied Analytics and Statistics Division (RAAS) has also not conducted any behavioral research studies on Combination Letters. IRS Response to TAS Information Request (Sept. 24, 2019).

The Combination Letter's Current Design May Limit Taxpayers' Ability to Understand and Exercise Their Appeal Rights

Cognitive science and behavioral psychology both inform us that, for better understanding, there should not be too many or conflicting messages in one communication.³¹ Yet, Combination Letters simultaneously tell taxpayers that they are under audit and that they can request an administrative appeal of a determination that the IRS has not yet made. While providing documentation and requesting an appeal is not an either/or situation, the design of the Combination Letter gives the appearance that taxpayers must make a choice between these two options.

For an example of how one Combination Letter deemphasizes appeal rights by relegating them to a single sentence, Letter 525 states the enclosed "Publication 3498-A describes the audit process and explains other options, including your appeal rights, if you disagree with our proposed changes."³² Moreover, in the same paragraph the taxpayer is told if he or she disagrees with the IRS's proposed changes, he or she must "[r]eturn a copy of this letter along with your explanation and any supporting documents."³³ Nowhere does the letter state that to protect their option to appeal at a later point in the audit, taxpayers must request an appeal within 30 days of the letter's date.

Considering the confusion the Combination Letter may cause, a taxpayer's right to a fair and just tax system is inadvertently violated by the IRS's use of this letter.

Behavioral science also shows that if a document requires readers to look elsewhere for information, they are much less likely to retrieve it.³⁴ The IRS merely mentioning Publication 3498-A, The Examination Process (Audits by Mail), in the Combination Letter does not fulfill the IRS's obligation to fully inform taxpayers of their appeal rights. The eight-page Publication 3498-A discusses the audit process but does not specifically address scenarios in which taxpayers receive an audit report with the initial contact letter (*i.e.*, Combination Letter).

The rate at which taxpayers request an Appeals conference is historically low in correspondence examinations (less than one percent).³⁵ Because appeal rates are so low, it is difficult to draw a definitive conclusion as to why affected taxpayers are not requesting an appeal, however taxpayers who receive Combination Letters request appeals at a rate consistently lower when compared to all correspondence examinations, as shown in Figure 1.9.3.

31 See National Taxpayer Advocate 2018 Annual Report to Congress vol. 2, at 193 (Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*).

32 See Letter 525.

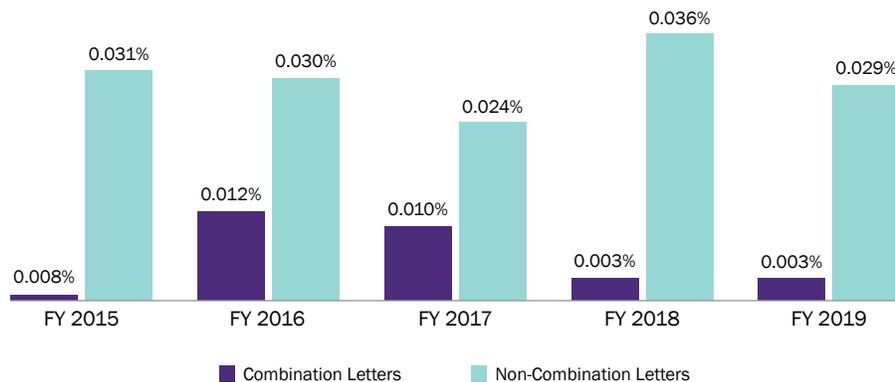
33 *Id.*

34 See National Taxpayer Advocate 2018 Annual Report to Congress vol. 2, at 193 (Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*).

35 Because the IRS does not track the type of initial contact letter sent, the exact number of Combination Letters versus non-Combination Letters could not be determined within the project codes designated at Figure 1.9.1 in comparison to the total correspondence exams started after September 30, 2014. IRS response to TAS fact check (Nov. 25, 2019).

FIGURE 1.9.3³⁶

Comparison of Appealed Closure Rates for Correspondence Audits by Type of Initial Contact Letter, FYs 2015-2019



IMPACT ON THE INTERNAL REVENUE SERVICE

The IRS uses Combination Letters because it believes they reduce the number of contacts with taxpayers, thereby reducing the cycle time for these cases. However, the IRS should want to positively engage with taxpayers rather than limiting interactions. The examination process should not only be used to resolve the issues under examination but also as an opportunity for the IRS to educate taxpayers. While reducing cycle time may be a valid goal to keep audits from unnecessarily dragging out, focusing solely on cycle times and limiting the number of interactions are potentially harmful to taxpayers. The IRS's aim should be to get to the correct answer, not just reduce case cycle times.

Regardless of its claim of the benefits of using the Combination Letter (namely saving employee resources by reducing taxpayer contacts and shortening case cycle times), the IRS can neither accurately identify the number and type of interactions it has with taxpayers who received the Combination Letter versus an Initial Contact Letter, nor can it accurately measure the cycle time for these same groups.³⁷ Thus, there is no evidence that taxpayer contacts or cycle times are notably better when the IRS uses Combination Letters rather than the two-letter process.³⁸ Despite the lack of data supporting its effectiveness, W&I is considering expanding the use of the Combination Letter to two additional project codes, which is concerning given the above issues.³⁹

³⁶ IRS response to TAS fact check (Nov. 25, 2019).

³⁷ IRS response to TAS information request (July 2, 2019).

³⁸ *Id.* Phone call with W&I and SB/SE on May 30, 2019.

³⁹ IRS response to TAS information request (July 2, 2019) (W&I is considering expanding use of the Combination Letter to “[Premium Tax Credit] within project code 1300 for specific error codes” and “Unallowable Project Code 0000 with Source Code 03 (for those items that are truly unallowable by law).”

CONCLUSION

Combination Letters negatively impact taxpayers because of the short timeframe taxpayers have to gather documentation, respond to the examiner, and request an appeal. Combination Letters may confuse taxpayers by giving the impression that the audit is a foregone conclusion. The design and wording of the Combination Letters may lead taxpayers to overlook or misunderstand their ability to request an appeal. Without considering the impact on taxpayers, the IRS is considering expanding the use of the Combination Letter.⁴⁰ The IRS can and should address these issues by using two separate notices, the Initial Contact Letter and the 30-Day Letter, in all audits, thereby reducing taxpayer confusion and protecting taxpayer rights.

RECOMMENDATIONS

Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Discontinue the use of Combination Letters and provide all taxpayers undergoing an examination with a separate Initial Contact Letter and 30-Day Letter, providing taxpayers with sufficient time to submit documentation and explanations before issuing the 30-Day Letter.
2. If the IRS chooses not to discontinue use of Combination Letters, it should work with the Taxpayer Advocate Service (TAS) on a joint study to track and compare Combination Letter data with Initial Contact Letter data to identify the causes of significant discrepancies between the two populations, as well as analyze potential issues and areas for improvement.
3. Refrain from expanding the use of Combination Letters until research is conducted on the impact to taxpayers and the IRS.
4. If the IRS continues to use Combination Letters, work with TAS to redesign them to clearly communicate to taxpayers:
 - a. Their tax return is under examination;
 - b. The possible outcomes of the audit, including what happens if the taxpayer provides documentation the IRS deems inadequate;
 - c. The timeframe in which they have to request an appeal and the factors that impact this timeframe; and
 - d. The steps they must take to request an appeal.
5. Revise IRS Publication 3498-A, The Examination Process (Audits by Mail), to include guidance specific to the Combination Letter.

⁴⁰ IRS response to TAS information request (July 2, 2019) (W&I is considering expanding use of the Combination Letter to “[Premium Tax Credit] within project code 1300 for specific error codes” and “Unallowable Project Code 0000 with Source Code 03 (for those items that are truly unallowable by law).”