

## Introduction: Legislative Recommendations

Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to include in her Annual Report to Congress, among other things, legislative recommendations to resolve problems encountered by taxpayers.

The chart immediately following this Introduction summarizes congressional action on legislative recommendations the National Taxpayer Advocate proposed in her 2001 through 2010 Annual Reports to Congress.<sup>1</sup> The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress has an opportunity to receive and consider a taxpayer perspective. The following discussion details recent developments relating to the National Taxpayer Advocate's proposals.

### Eliminate Tax Strategy Patents

In 2007, the National Taxpayer Advocate recommended eliminating tax strategy patents because they grant private citizens monopolies on the application of our tax laws.<sup>2</sup> Allowing taxpayers to obtain these patents misleads taxpayers into believing the government has approved a patented tax strategy, increases the cost of tax compliance and advice, and undermines congressionally-created tax incentives. In 2011, Congress passed the Leahy-Smith America Invents Act, which eliminates patents for any strategy seeking to reduce, avoid, or defer tax liability.<sup>3</sup>

### Increase Compliance and Oversight of Federal Return Preparers

In 2003, the National Taxpayer Advocate recommended a number of changes to impose an effective penalty regime on return preparers. Among proposals for Earned Income Tax Credit (EITC) penalty reform and due diligence requirements, the National Taxpayer Advocate recommended a tiered penalty structure for preparers violating the EITC due diligence requirements, with penalties of \$100 for any occurrences during the first year, \$500 for those during the second year, and \$1,000 for those during the third year. The United States-Korea Free Trade Agreement Implementation Act, which became law in 2011, increased the maximum amount of the EITC due diligence penalty for return preparers to \$500 for returns required to be filed after December 31, 2011.<sup>4</sup>

<sup>1</sup> An electronic version of the chart is available on the TAS website at <http://www.irs.gov/advocate>.

<sup>2</sup> National Taxpayer Advocate 2007 Annual Report to Congress 512-524.

<sup>3</sup> Pub. L. No. 112-29, § 14(a), 125 Stat. 284, 327 (2011).

<sup>4</sup> Pub. L. No. 112-41, § 501, 125 Stat. 428, 459 (2011). The Taxpayer Advocacy and Government Accountability Promotion Act of 2011, S. 1289, 112th Cong. (2011), discussed *infra*, also proposed raising the EITC due diligence penalty to \$500.

## Introduction: Legislative Recommendations

**Repeal the Alternative Minimum Tax for Individuals**

The National Taxpayer Advocate has advocated for changes to the Alternative Minimum Tax (AMT) numerous times since her first Annual Report to Congress in 2001. Although the AMT initially was enacted to prevent wealthy taxpayers from avoiding tax, the AMT now affects many middle-class taxpayers, significantly increasing their tax liabilities and imposing burden on them to calculate the AMT correctly under a complex set of rules. The AMT was the number one Most Serious Problem in the National Taxpayer Advocate's 2003 and 2006 Annual Reports to Congress.<sup>5</sup> The National Taxpayer Advocate recommended repealing the AMT for individuals in her Annual Reports to Congress in 2001, 2004, 2008, and again in 2010, as part of fundamental tax reform.<sup>6</sup> Numerous bills introduced in 2011 would repeal the AMT entirely, either for individuals or for both individuals and corporations.<sup>7</sup> The Fair and Simple Tax Act of 2011<sup>8</sup> calls for indexing the AMT for inflation, and the Tax Relief Certainty Act of 2011<sup>9</sup> would phase in increases in the AMT exemption amount between 2011 and 2021 and make offsets against the AMT for certain nonrefundable tax credits permanent.

**Simplify the Tax Code**

The National Taxpayer Advocate has made numerous recommendations in her Annual Reports to Congress to simplify the tax code, including recommendations regarding the family status provisions,<sup>10</sup> education tax incentives,<sup>11</sup> retirement savings incentives,<sup>12</sup> phase-out provisions,<sup>13</sup> sunsets,<sup>14</sup> overall tax reform,<sup>15</sup> providing taxpayers with a pre-populated

<sup>5</sup> National Taxpayer Advocate 2003 Annual Report to Congress 5-19 (Most Serious Problem: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2006 Annual Report to Congress 3-5 (Most Serious Problem: *Alternative Minimum Tax for Individuals*). In both reports, the National Taxpayer Advocate identified the lack of adjustment for inflation as one of the problems with the AMT.

<sup>6</sup> National Taxpayer Advocate 2001 Annual Report to Congress 166-178 (Legislative Recommendation: *Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2004 Annual Report to Congress 383-385 (Legislative Recommendation: *Alternative Minimum Tax*); National Taxpayer Advocate 2008 Annual Report to Congress 356-362 (Legislative Recommendation: *Repeal the Alternative Minimum Tax for Individuals*); National Taxpayer Advocate 2010 Annual Report to Congress 368-369 (Legislative Recommendation: *Enact Tax Reform Now*). The National Taxpayer Advocate has also testified before both houses of Congress on problems created by the AMT. See *Alternative Minimum Tax: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways & Means* (Mar. 7, 2007) (statement of Nina E. Olson, National Taxpayer Advocate); *Blowing the Cover on the Stealth Tax: Exposing the Individual AMT: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Senate Comm. on Finance* (May 23, 2005) (statement of Nina E. Olson, National Taxpayer Advocate).

<sup>7</sup> See S. 727, 112th Cong. (2011); S. 820, 112th Cong. (2011); H.R. 86, 112th Cong. (2011); H.R. 547, 112th Cong. (2011); H.R. 3400, 112th Cong. (2011). Both Senate bills propose repealing the AMT for individual and corporate taxpayers, while the three House bills would repeal the AMT only for individuals.

<sup>8</sup> H.R. 99, 112th Cong. (2011).

<sup>9</sup> S. 336, 112th Cong. (2011); H.R. 696, 112th Cong. (2011).

<sup>10</sup> See, e.g., National Taxpayer Advocate 2008 Annual Report to Congress 363-369 (Legislative Recommendation: *Simplify the Family Status Provisions*).

<sup>11</sup> See *id.* at 370-372 (Legislative Recommendation: *Simplify and Streamline Education Tax Incentives*).

<sup>12</sup> See *id.* at 373-374 (Legislative Recommendation: *Simplify and Streamline Retirement Savings Tax Incentives*).

<sup>13</sup> See *id.* at 410-413 (Legislative Recommendation: *Eliminate (or Simplify) Phase-Outs*).

<sup>14</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 397-409 (Legislative Recommendation: *Eliminate (or Reduce) Procedural Incentives for Lawmakers to Enact Tax Sunsets*).

<sup>15</sup> See *Tax Reform: Hearing Before the H. Comm. on Ways and Means* (Jan. 20, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); *Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due: Hearing Before the S. Comm. on Finance* (June 28, 2011) (statement of Nina E. Olson, National Taxpayer Advocate); National Taxpayer Advocate 2010 Annual Report to Congress 365-372 (Legislative Recommendation: *Enact Tax Reform Now*).

return,<sup>16</sup> and providing taxpayers with an itemized receipt to show how their tax dollars are spent.<sup>17</sup>

The Bipartisan Tax Fairness and Simplification Act of 2011 generally incorporates many of these recommendations.<sup>18</sup> The bill would combine current education-related tax credits and deductions into a single tax credit for all education expenses, including tuition, fees, and student loan interest.<sup>19</sup> It would consolidate retirement savings plans into one category.<sup>20</sup> It would eliminate many sunsets created by the Economic Growth and Tax Relief Reconciliation Act of 2001<sup>21</sup> by permanently repealing phase-out provisions for the EITC, the dependent care credit, the child tax credit, personal exemptions, and limitations on itemized deductions.<sup>22</sup> It would further simplify the tax code by reducing the number of tax preferences.<sup>23</sup> In addition to general simplification provisions, the bill would make the return filing process easier for taxpayers by providing any taxpayer, upon request, with a simplified pre-prepared tax return based on the information the IRS has received from third parties.<sup>24</sup> Taxpayers also would receive a one-page summary showing how the most recently available fiscal year's revenue was spent.<sup>25</sup>

### Reduce the Tax Gap to Promote Tax Fairness

The National Taxpayer Advocate has made numerous recommendations to reduce the tax gap, which is important to ensure that compliant taxpayers are not effectively required to subsidize noncompliance by others. The Taxpayer Advocacy and Government Accountability Promotion Act of 2011 (also known as the “TAX GAP Act”) includes many of the National Taxpayer Advocate's recommendations.<sup>26</sup> In 2007, The National Taxpayer Advocate focused on the portion of the tax gap associated with the cash economy<sup>27</sup> and recommended requiring financial institutions to report all bank accounts to the IRS, thus eliminating the \$10 interest reporting threshold currently required by IRC § 6049(a).<sup>28</sup> The

<sup>16</sup> See Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration*, *supra*.

<sup>17</sup> See National Taxpayer Advocate 2010 Annual Report to Congress at 368.

<sup>18</sup> S. 727, 112th Cong. (2011).

<sup>19</sup> *Id.* at § 114.

<sup>20</sup> *Id.* at § 112.

<sup>21</sup> Pub. L. No. 107-16, 115 Stat. 38 (2001).

<sup>22</sup> S. 727, 112th Cong. §§ 103-106 (2011).

<sup>23</sup> *Id.* at §§ 107 & 115.

<sup>24</sup> *Id.* at § 116.

<sup>25</sup> *Id.* The National Taxpayer Advocate recommended a summary be given to each taxpayer presenting a general breakdown of how federal dollars are spent. National Taxpayer Advocate 2010 Annual Report to Congress 368 (Legislative Recommendation: *Enact Tax Reform Now*).

<sup>26</sup> S. 1289, 112th Cong. (2011).

<sup>27</sup> “Cash economy” refers to income from legal activities that is not reported to the IRS by third parties. National Taxpayer Advocate 2007 Annual Report to Congress vi, fn. 1.

<sup>28</sup> National Taxpayer Advocate 2007 Annual Report to Congress 501-502 (Legislative Recommendation: *Measures to Address Noncompliance in the Cash Economy*).

## Introduction: Legislative Recommendations

TAX GAP Act would remove this minimum interest requirement.<sup>29</sup> Also related to reporting information, the Act would adopt the National Taxpayer Advocate's recommendation to revise Form 1040, Schedule C by breaking out income that is not reported on information returns.<sup>30</sup>

In 2007, the National Taxpayer Advocate recommended that Congress give the National Taxpayer Advocate the authority to make *de minimis* apology payments to taxpayers when the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer and the taxpayer meets the significant hardship definition in IRC § 7811.<sup>31</sup> Such payments could improve voluntary compliance by promoting greater public confidence in the fairness of the tax system. These payments would be excluded from gross income, and the National Taxpayer Advocate could include a summary of any payments granted in the preceding year in her Annual Report to Congress to provide Congress with more information about areas in which the IRS is imposing undue expense or burden on taxpayers. The TAX GAP Act would give the National Taxpayer Advocate this authority and require the National Taxpayer Advocate to summarize all apology payments granted in her Annual Report to Congress.<sup>32</sup> In addition, the bill would require the Secretary of the Treasury to submit to Congress a report on the apology payments program not later than December 31, 2013.<sup>33</sup>

Another way to improve tax compliance is to reduce the number of misclassified workers. In 2008, the National Taxpayer Advocate highlighted that the misclassification of employees as independent contractors has a significant revenue impact due to the comparatively limited information reporting and tax withholding requirements for many self-employed workers.<sup>34</sup> Among a suite of recommendations, the National Taxpayer Advocate proposed that Congress direct the Treasury Department and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.<sup>35</sup> The TAX GAP Act would require the Treasury Department to submit to Congress two reports on worker classification for each fiscal year, one focusing on examinations of employers and the other providing statistical estimates of the number of misclassified workers and the impact on the employment tax gap.<sup>36</sup>

The TAX GAP Act also encourages revenue collection by promoting collection alternatives. The National Taxpayer Advocate has long advocated for more widespread access to collec-

<sup>29</sup> S. 1289, 112th Cong. § 303(a) (2011).

<sup>30</sup> *Id.* at § 201(a). National Taxpayer Advocate 2004 Annual Report to Congress 488 (Legislative Recommendation: *Tax Gap Recommendations*); National Taxpayer Advocate 2010 Annual Report to Congress 40 (Most Serious Problem: *The Cash Economy*).

<sup>31</sup> National Taxpayer Advocate 2007 Annual Report to Congress 480 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology Payments"*).

<sup>32</sup> S. 1289, 112th Cong. § 107 (2011).

<sup>33</sup> *Id.*

<sup>34</sup> National Taxpayer Advocate 2008 Annual Report to Congress 375 (Legislative Recommendation: *Worker Classification*).

<sup>35</sup> *Id.* at 376.

<sup>36</sup> S. 1289, 112th Cong. § 703 (2011).

tion alternatives for taxpayers who cannot pay their liabilities in full upon assessment.<sup>37</sup> The TAX GAP Act would enact her 2006 recommendation to eliminate the 20 percent down payment requirement for lump-sum offers-in-compromise.<sup>38</sup>

Another provision of the TAX GAP Act would require any return that is prepared electronically but filed on paper to contain a matrix code or 2D barcode that could convert the return to an electronic format when scanned.<sup>39</sup> The National Taxpayer Advocate previously proposed 2D bar-coding as a possible bridge for taxpayers who are reluctant to file electronically.<sup>40</sup>

### Promote Awareness of and Access to Low Income Taxpayer Clinics (LITCs)

The National Taxpayer Advocate has repeatedly stressed the importance of LITCs and has asked the IRS to promote the services of LITCs and educate taxpayers about their existence.<sup>41</sup> The version of the FY 2012 Financial Services and General Government Appropriations bill approved by the Senate Appropriations Committee contained a provision that would have authorized the IRS to refer taxpayers to specific LITCs.<sup>42</sup>

### Legislative Recommendations Advanced by Administrative or Judicial Actions

In 2002 and in subsequent reports, the National Taxpayer Advocate recommended that Congress regulate federal income tax return preparers.<sup>43</sup> In 2009 and 2010, the IRS on its own established a framework to regulate paid tax return preparers. In 2011, all tax return preparers were required for the first time to register with the IRS, and preparers other than attorneys, CPAs and Enrolled Agents, generally will be required to pass a competency exam and take annual continuing education courses. Because approximately 60 percent of taxpayers use paid preparers, this is a significant achievement that should go a long

<sup>37</sup> See, e.g., National Taxpayer Advocate 2006 Annual Report to Congress 507-519 (Legislative Recommendation: *Improve Offer in Compromise Eligibility*).

<sup>38</sup> S. 1289, 112th Cong. § 103 (2011). National Taxpayer Advocate 2006 Annual Report to Congress 507-519 (Legislative Recommendation: *Improve Offer in Compromise Eligibility*). A lump-sum offer is one in which all payments would be made in five or fewer installments. IRC § 7122(c).

<sup>39</sup> S. 1289, 112th Cong. § 204 (2011).

<sup>40</sup> National Taxpayer Advocate 2004 Annual Report to Congress 101-102 (Most Serious Problem: *Electronic Return Preparation and Filing*).

<sup>41</sup> See, e.g., National Taxpayer Advocate 2007 Annual Report to Congress 551-553.

<sup>42</sup> S. 1573, 112th Cong. Title I (2011).

<sup>43</sup> See Status Update: *The IRS Has Made Significant Progress in Developing and Implementing a System to Register and Test Return Preparers*, *supra*; National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2008 Annual Report to Congress 423-427 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2005 Annual Report to Congress 223-237 (Most Serious Problem: *Regulation of Electronic Return Originators*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight Of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers Oversight And Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-230 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*); see also *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

## Introduction: Legislative Recommendations

way toward both protecting taxpayers from unscrupulous and incompetent preparers and improving return accuracy.<sup>44</sup>

In 2006 and 2010, the National Taxpayer Advocate recommended that Congress overturn a two-year limitation imposed by regulation on the right of taxpayers to obtain equitable innocent spouse relief.<sup>45</sup> In July 2011, the Commissioner announced that the IRS will no longer apply the two-year limit to equitable innocent spouse relief requests.<sup>46</sup> In general, married taxpayers who file joint tax returns are jointly and severally liable for their tax liabilities, but a taxpayer may qualify for an exception pursuant to the “innocent spouse” rules. Under the two-year limitation, many taxpayers who otherwise qualified for equitable innocent spouse relief were not able to obtain it because they did not know the IRS had initiated collection activity until after more than two years had passed.

In 2009, the National Taxpayer Advocate recommended that Congress direct the Treasury Department to prepare a report identifying the administrative and legislative steps required to allow the IRS to receive and process information reporting documents before it processes tax returns.<sup>47</sup> In April 2011, the Commissioner announced that this will become a major IRS initiative.<sup>48</sup>

In 2010, the National Taxpayer Advocate recommended that Congress require the redaction of third-party return information in proceedings relating to whistleblower claims. The intent was to ensure that the confidential tax return information of taxpayers who are the subject in whistleblower claims is adequately protected.<sup>49</sup> In December 2011, the U.S. Tax Court announced proposed amendments to its Rules of Practice and Procedure that would, among other things, provide privacy protections in whistleblower cases.<sup>50</sup> In the Tax Court’s explanation for the proposed change relating to whistleblower cases, the National Taxpayer Advocate’s concerns were noted and discussed in detail.<sup>51</sup>

<sup>44</sup> *Hearing on Return Preparation Program Before the U.S. House Comm. On Ways and Means, Subcommittee on Oversight 5* (Written Statement of David R. Williams, Director, Return Preparer Office, IRS) (July 28, 2011).

<sup>45</sup> National Taxpayer Advocate 2010 Annual Report to Congress 377-382 (Legislative Recommendation: *Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at Any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions*); National Taxpayer Advocate 2006 Annual Report to Congress 540-541 (Legislative Recommendation: *Eliminate the Two-Year Limitation Period for Taxpayers Seeking Equitable Relief under IRC §§ 6015 or 66*).

<sup>46</sup> See IRS News Release, IR-2011-80, *Two-Year Limit No Longer Applies to Many Innocent Spouse Requests* (July 25, 2011).

<sup>47</sup> National Taxpayer Advocate 2009 Annual Report to Congress 338-345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the “Pay Refunds First, Verify Eligibility Later” Approach to Tax Return Processing*).

<sup>48</sup> IRS News Release, IR-2011-38, Prepared Remarks of IRS Commissioner Doug Shulman at the National Press Club (April 6, 2011), available at <http://www.irs.gov/newsroom/article/0,,id=238204,00.html>.

<sup>49</sup> National Taxpayer Advocate 2010 Annual Report to Congress 396-399 (Legislative Recommendation: *Protect Taxpayer Privacy in Whistleblower Cases*).

<sup>50</sup> See new proposed rule 345, in which a whistleblower can proceed anonymously in the Tax Court, and the name, address, and other identifying information of the taxpayer to which the whistleblower claim relates must be redacted.

<sup>51</sup> See United States Tax Court, Press Release (Dec. 28, 2011), available at <http://www.ustaxcourt.gov/press/122811.pdf>.

## Summary of 2011 Legislative Recommendations

We continue to advocate for the proposals we have made previously. In this report, we highlight some of the recommendations made in previous reports that will protect taxpayer rights. In addition, we present 13 new legislative recommendations, which are summarized below.

- 1. Enact Previous Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights.** Over the last decade, the National Taxpayer Advocate has recommended many legislative changes that would serve to protect taxpayer rights. At a time when the IRS budget is shrinking and resources are shifting to enforcement, taxpayer rights must be a priority. The National Taxpayer Advocate urges Congress to enact the legislative recommendations detailed in previous annual reports, beginning with the 2007 recommendation to codify a taxpayer bill of rights (TBOR) that would explicitly detail the rights and responsibilities of taxpayers. The proposed TBOR includes the following rights: the right to be informed; the right to be assisted; the right to be heard; the right to pay no more than the correct amount of tax; the right of appeal; the right to certainty; the right to privacy; the right to confidentiality; the right to representation; and the right to a fair and just tax system. Proposed taxpayer responsibilities include: the obligation to be honest; the obligation to be cooperative; the obligation to provide accurate information and documents on time; the obligation to keep records; and the obligation to pay taxes on time.
- 2. Restrict Access to the Death Master File.** Earlier in this report, the National Taxpayer Advocate recognized identity theft as one of the Most Serious Problems affecting taxpayers. In a relatively new tactic, some identity thieves are filing tax returns that claim the dependency exemption and various tax credits using the Social Security number (SSN) of deceased individuals. The Social Security Administration's "Death Master File" (DMF) provides the public with easy access to SSNs and other personal information of the deceased. The National Taxpayer Advocate recommends that Congress enact legislation to restrict access to certain personally identifiable information in the DMF and outlines several options for doing so. Congress could create an exemption under the Freedom of Information Act; it could adopt the approach it uses to govern the confidentiality and disclosure of tax return information; or it could mandate that a truncated version of the SSN (*e.g.*, only the last four digits) be included in the DMF to prevent the theft and misuse of the decedents' identities.
- 3. Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights.** IRC §§ 6213(b) and (g) authorize the IRS to use its math error authority to summarily assess tax and bypass normal deficiency procedures. Originally, math error authority was intended to apply only to simple mathematical and clerical errors, but over the years, Congress has expanded its use to a compliance context. To ensure that IRS use of math error authority does not impair taxpayers' rights and minimizes burden to both the taxpayer and the IRS, the National Taxpayer Advocate recommends that

Congress require the IRS to develop math error notices that clearly describe what is being changed and why, and tell the taxpayer what steps he or she should take to contest the change. The National Taxpayer Advocate further recommends that Congress limit any future expansion of math error authority to instances that are not factually complex, can be verified on accurate, reliable government databases, and do not require the IRS to analyze facts and circumstances or weigh the adequacy of information. Finally, the National Taxpayer Advocate recommends that Congress restrict math error authority in situations with a high abatement rate.

- 4. Clarify that the Scope and Standard of Tax Court Determinations Under IRC § 6015(f) Is *De Novo*.** Married taxpayers who file joint returns are jointly and severally liable for any deficiency or unpaid tax. An “innocent spouse” statute, IRC § 6015, provides for relief from deficiencies in specific circumstances, and “equitable” relief under IRC § 6015(f) when relief is not otherwise available under IRC § 6015. Equitable relief under IRC § 6015(f) is appropriate when, taking into account all the facts and circumstances, it would be inequitable to hold the taxpayer liable for the deficiency or unpaid tax. The Tax Court has held that the scope and standard of review in IRC § 6015(f) cases is *de novo*, meaning that it may consider evidence introduced at trial that was not included in the administrative record, and it will consider the case anew, without deference to the agency determination to deny relief. The IRS disagrees with the Tax Court’s opinions and maintains that the scope of the Tax Court’s review is limited to the administrative record, and the proper standard of review is abuse of discretion. The IRS’s position is especially harmful to taxpayers who cannot afford representation or assistance during administrative proceedings, or those who are victims of domestic violence or abuse. The divergence between Counsel’s position and that of the Tax Court creates uncertainty for taxpayers and consumes administrative and judicial resources. The National Taxpayer Advocate recommends that Congress amend IRC § 6015 to specify that the scope and standard of review in Tax Court determinations under IRC § 6015(f) is *de novo*.
- 5. Amend IRC § 6343(a) to Permit the IRS to Release Levies on Business Taxpayers That Impose Economic Hardship.** The IRS should generally reserve levy actions for situations where a taxpayer is unwilling to cooperate or comply. Yet longstanding IRS regulations under IRC § 6343(a) relieve individuals, but not businesses, from levies on the grounds of economic hardship, leading the IRS to use levies in lieu of collection alternatives. The National Taxpayer Advocate recommends that Congress amend IRC § 6343(a)(1)(D) to: permit the IRS, in its discretion, to release a levy against the taxpayer’s property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer’s business; and require the IRS, in making the determination to release a levy against a business on economic hardship grounds, to consider the economic viability of the business, the nature and extent of the hardship (including whether the taxpayer exercised ordinary business care and prudence), and the potential harm to individuals

if the business is liquidated, as well as whether the taxes could be collected from a responsible person under an IRC § 6672 Trust Fund Recovery Penalty assessment.

6. **Amend the Erroneous Refund Penalty to Permit Relief in Case of Reasonable Cause for Claim to Refundable Credits.** Even if they do not owe tax, businesses and individuals may claim a refund due to a special tax break such as one designed to support home ownership or health care. Many special tax breaks are refundable credits commonly known as “negative taxes” targeted at small business, low and middle-income taxpayers, who may be challenged by the complexity of the tax law. Misunderstanding the rules may leave these taxpayers charged with a penalty of a fifth of their denied claim, even if they started with no taxable income from which to pay. As enacted, the erroneous refund penalty may apply not only to claims without reasonable basis but also to inadvertent errors for which a confused taxpayer may have reasonable cause. The National Taxpayer Advocate recommends that Congress amend the erroneous refund penalty under IRC § 6676 to permit relief from a penalty for erroneously claiming a refund for a refundable credit if the taxpayer acted with reasonable cause and in good faith.
7. **Authorize the IRS Office of Appeals to Rescind Notices of Determination Issued in Collection Due Process Cases.** Before the IRS can seize a taxpayer’s assets or after it has filed a Notice of Federal Tax Lien (NFTL) against the taxpayer, the Office of Appeals (Appeals) is generally required to hold a Collection Due Process (CDP) hearing for a taxpayer who requests a hearing and states grounds for the request. After a hearing, Appeals issues a notice of determination (NOD), giving the taxpayer 30 days to petition the Tax Court for review. Appeals officers are not required to review or consider information submitted by the taxpayer after Appeals issues the NOD. In some cases, Appeals issues a NOD before the taxpayer has had an opportunity to present information. Yet the Code does not authorize Appeals to rescind CDP NODs or rehear issues. The National Taxpayer Advocate recommends that Congress amend IRC § 6330 to permit the IRS Office of Appeals, with the consent of the taxpayer, to rescind CDP NODs in cases where the taxpayer has raised a legitimate concern regarding the NOD within the 30-day period for petitioning the Tax Court, and before the taxpayer has requested Tax Court review.
8. **Clarify that the Emergency Exception to the Anti-Deficiency Act Includes IRS Activities that Protect Taxpayer Life and Property.** When the appropriation of funds for a federal agency for a fiscal year expires without a continuing resolution or new appropriation for the current fiscal year, the Anti-Deficiency Act generally prohibits the agency from incurring obligations to pay its employees. An agency cannot employ the personal services of its employees even without incurring obligations to pay them, but with an important exception: for emergencies involving the safety of human life or the protection of property. The National Taxpayer Advocate believes that two IRS contingency shutdown plans, developed in 2011 in anticipation of lapses in appropriations, would prevent it from assisting taxpayers even in emergencies involving the safety of

human life or the protection of property. The National Taxpayer Advocate's authority to issue Taxpayer Assistance Orders pursuant to IRC § 7811 does not explicitly include the authority to incur obligations in advance of appropriations and thus may not compensate for the current inability to assist taxpayers. The National Taxpayer Advocate recommends that Congress clarify that the emergency exception to the Anti-Deficiency Act includes IRS activity involving the safety of human life, including taxpayer life, or the protection of property, including taxpayer property. Alternatively, the National Taxpayer Advocate recommends that Congress clarify that the National Taxpayer Advocate's authority to issue Taxpayer Assistance Orders pursuant to IRC § 7811 continues during a lapse in appropriations and includes the authority to incur obligations in advance of appropriations, and that the IRS can incur obligations in advance of appropriations to comply with any Taxpayer Assistance Order issued under IRC § 7811.

9. **Assessment of Civil Penalties Against Preparers of Fraudulent Returns.** A small segment of the tax return preparer community defrauds taxpayers and the IRS by altering taxpayers' returns without their knowledge. In these schemes, the preparers completed and taxpayers signed correct tax returns that claimed refunds, but the preparers later altered the returns without the taxpayers' knowledge to claim increased refunds that the taxpayers were not entitled to receive. The preparers filed the altered returns with the IRS, which either remitted the inflated refunds to the preparers, who deposited the amounts shown on the correct returns into taxpayers' bank accounts and deposited the excess into their own accounts, or split the refund between the preparer's and taxpayer's bank accounts, as indicated on the return. In these cases, the IRS may penalize the preparer, but the amount of any penalty is generally far below the amount of the refund received by the preparer. Moreover, the government must file a costly suit in court to collect the excess refund from the preparer. The National Taxpayer Advocate recommends that Congress amend the Code to provide that when the issuance of an erroneous refund to a return preparer is due to fraud, the IRS may impose a penalty, in addition to other penalties provided by law, equal to 100 percent of that erroneous refund.
10. **Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing "Cyber Assistant."** When an organization's exempt status under IRC § 501(c)(3) is revoked, the organization becomes subject to tax and its donors can no longer deduct their contributions. The Pension Protection Act of 2006 (PPA) imposed a new annual filing requirement on small exempt organizations and provides that the exempt status of any exempt organization failing to file for three consecutive years is *automatically* revoked. The PPA does not prohibit administrative review of an IRS conclusion of automatic revocation. However, the IRS declines to provide such a review, and advises taxpayers to contact the IRS, or to apply for reinstatement by filling out a full Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, which the IRS estimates takes *more than two weeks* to complete. The National Taxpayer Advocate makes the following recommendations

to Congress: require the IRS to allow administrative review of its conclusion that an organization's exempt status was automatically revoked; require the IRS to develop a Form 1023-EZ; and require and provide sufficient funding for the IRS to implement Cyber Assistant for use in preparing applications for recognition of exempt status.

11. **Allow Individual U.S. Taxpayers Residing Abroad the Option to Choose the Currency of Their Country of Residence as Their Functional Currency.** For millions of U.S. taxpayers living abroad, the measurement of U.S. taxable income may be complicated and distorted when those taxpayers receive income or pay expenses in a foreign currency. Current law requires taxpayers to make all federal income tax determinations in their functional currencies, which is generally the U.S. dollar for individual U.S. taxpayers. This requirement raises two problems. First, taxpayers receiving payments in a foreign currency must translate into dollars all the income they receive and all the deductible expenses they pay in the foreign currency, using the prevailing exchange rate as of the date each item of income or expense is paid, received, or accrued. Second, currency fluctuations may create capital gains even on routine personal transactions. The National Taxpayer Advocate recommends that Congress amend IRC § 985 to allow individual U.S. taxpayers residing abroad to elect to use the currency of their country of residence (or "tax home" as defined for the purposes of IRC § 911) as their functional currency, giving individuals the flexibility currently extended to business taxpayers.
12. **Codify the Authority of the Office of the Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives.** The National Taxpayer Advocate is required to assist taxpayers in resolving problems with the IRS, to identify areas where frequent problems occur or that are the frequent subject of litigation, and to identify administrative and legislative solutions. Despite these mandates, the National Taxpayer Advocate is not authorized to participate in litigation. Issues of interest to numerous taxpayers may come before the judiciary or arise in proposed regulations with no one representing the rights of taxpayers in general. In the course of assisting taxpayers or identifying frequent problems, the National Taxpayer Advocate uses her authority to issue Taxpayer Advocate Directives (TADs) that direct IRS units to change procedures to protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service. However, the IRS may not comply with or even respond to a Taxpayer Advocate Directive because it comes not under a statute but merely a delegated power that the Commissioner could revoke.

The National Taxpayer Advocate recommends that Congress authorize the National Taxpayer Advocate to appoint an independent Counsel to the National Taxpayer Advocate, who shall report directly to the National Taxpayer Advocate. The National Taxpayer Advocate should have the authority to submit *amicus curiae* briefs in federal appellate litigation on matters relating to the protection of taxpayer rights that the National Taxpayer Advocate has identified as a Most Litigated Issue or Most Serious Problem. Further, Congress should require the IRS to submit proposed and temporary

regulations to and receive comments from the Office of the Taxpayer Advocate within a reasonable time and address those comments in the preamble to such regulations. The National Taxpayer Advocate recommends that Congress grant the National Taxpayer Advocate nondelegable authority to issue a TAD with respect to any IRS program, proposed program, action, or failure to act that may create a significant hardship for a segment of the taxpayer population or for taxpayers at large, and require that, to object to a TAD, the IRS would have to respond timely in writing. Finally, Congress should amend IRC § 7811 to require the IRS to raise its objections to a Taxpayer Assistance Order issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the Order.

- 13. Appoint an IRS Historian.** From time to time, the IRS undertakes initiatives to improve tax administration, with both successes and failures. Generally, federal laws require retention of and access to IRS and other government records, but no law requires IRS publication of history and no unit of the IRS is charged with recording these events. Thoughtful study of history can help accomplish a mission because understanding agency origins and development aids in comprehending the present situation and illuminates possible future directions. Knowledge of history can prevent the IRS from repeating past efforts that proved fruitless. The National Taxpayer Advocate recommends that Congress create a permanent position within the IRS for a historian with expertise in federal taxation as well as archival methods. Congress should mandate that the IRS historian record history objectively, accurately, and without deletion. To ensure historical expertise regardless of contemporary IRS policies, the National Taxpayer Advocate recommends that the historian be appointed by the Secretary of the Treasury in consultation with the Archivist of the United States.

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

Alternative Minimum Tax (AMT)				
<b>Repeal the Individual AMT</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 82-100; National Taxpayer Advocate 2004 Annual Report to Congress 383-385; National Taxpayer Advocate 2008 Annual Report to Congress 356-362.		Repeal the AMT outright.		
	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	HR 86	Bachmann	1/5/2011	Referred to Ways & Means Committee
	HR 99	Dreler	1/5/2011	Referred to Ways & Means Committee
	HR 547	Garrett	2/8/2011	Referred to Ways & Means Committee
	HR 3400	Garrett	11/10/2011	Referred to Ways & Means Committee
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
	S 820	Shelby	4/14/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3018	Wyden	2/23/2010	Referred to the Finance Committee
	HR 240	Garrett	1/7/2009	Referred to the Ways & Means Committee
	HR 782	Paul	1/28/2009	Referred to the Ways & Means Committee
	S 932	Shelby	4/30/2009	Referred to the Finance Committee
Legislative Activity 110th Congress	S 55	Baucus	1/4/2007	Referred to the Finance Committee
	S 14	Kyl	4/17/2007	Referred to the Finance Committee
	S 1040	Shelby	3/29/2007	Referred to the Finance Committee
	HR 1365	English	3/7/2007	Referred to the Ways & Means Committee
	HR 1942	Garrett	4/19/2007	Referred to the Ways & Means Committee
	HR 3970	Rangel	10/25/2007	Referred to the Ways & Means Committee
	S 2293	Lott	11/1/2007	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 464
Legislative Activity 109th Congress	HR 1186	English	3/9/2005	Referred to the Ways & Means Committee
	S 1103	Baucus	5/23/2005	Referred to the Finance Committee
	HR 2950	Neal	6/16/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 43	Collins	1/7/2003	Referred to the Ways & Means Committee
	HR 1233	English	3/12/2003	Referred to the Ways & Means Committee
	S 1040	Shelby	5/12/2003	Referred to the Finance Committee
	HR 3060	N. Smith	9/10/2003	Referred to the Ways & Means Committee
	HR 4131	Houghton	4/2/2004	Referred to the Ways & Means Committee
	HR 4164	Shuster	4/2/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 437	English	2/6/2001	Referred to the Ways & Means Committee
	S 616	Hutchison	3/26/2002	Referred to the Finance Committee
	HR 5166	Portman	7/18/2002	Referred to the Ways & Means Committee

Legislative Recommendations

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

<b>Index AMT for Inflation</b>																									
National Taxpayer Advocate 2001 Annual Report to Congress 82-100.	If full repeal of the individual AMT is not possible, it should be indexed for inflation.																								
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Legislative Activity 108th Congress	HR 22 Houghton 1/7/2003 Referred to the Ways & Means Committee																								
Legislative Activity 107th Congress	HR 5505 Houghton 10/1/2002 Referred to the Ways & Means Committee																								
<b>Eliminate Several Adjustments for Individual AMT</b>																									
National Taxpayer Advocate 2001 Annual Report to Congress 82-100.	Eliminate personal exemptions, the standard deduction, deductible state and local taxes, and miscellaneous itemized deductions as adjustment items for individual AMT purposes.																								
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<b>Private Debt Collection (PDC)</b>																									
<b>Repeal PDC Provisions</b>																									
National Taxpayer Advocate 2006 Annual Report to Congress 458-462.	Repeal IRC § 6306, thereby terminating the PDC initiative.																								
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<b>Tax Preparation and Low Income Taxpayer Clinics (LITC)</b>																									
<b>Matching Grants for LITC for Return Preparation</b>																									
National Taxpayer Advocate 2002 Annual Report to Congress vii-viii.	Create a grant program for return preparation similar to the LITC grant program. The program should be designed to avoid competition with VITA and should support the IRS's goal (and need) to have returns electronically filed.																								
Legislative Activity 111th Congress	<b>Pub. L. No. 111-117, Div. C, Title I, 123 Stat. 3034, 3163 (2009).</b>																								
Legislative Activity 110th Congress	<b>Pub. L. No. 110-161, Div. D, Title I, 121 Stat. 1975, 1976 (2007).</b>																								
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National Taxpayer Advocate Legislative Recommendations with Congressional Action

Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006-Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006-Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	S 476	Grassley	2/27/2003	Referred to the Finance Committee
	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004-S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002-Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2001	Referred to the Ways & Means Committee
	HR 7	Baucus	7/16/2002	Reported by Chairman Baucus with an amendment; referred to the Finance Committee
<p><b>Regulation of Income Tax Return Preparers</b></p> <p>National Taxpayer Advocate 2002 Annual Report to Congress 216-230; National Taxpayer Advocate 2003 Annual Report to Congress 270-301; National Taxpayer Advocate 2007 Annual Report to Congress 83-95 &amp; 140-155; National Taxpayer Advocate 2008 Annual Report to Congress 423-426; National Taxpayer Advocate 2009 Annual Report to Congress 41-69.</p>		<p>Create an effective oversight and penalty regime for return preparers by taking the following steps:</p> <ul style="list-style-type: none"> <li>◆ Enact a registration, examination, certification, and enforcement program for federal tax return preparers;</li> <li>◆ Direct the Secretary of the Treasury to establish a joint task force to obtain accurate data about the composition of the return preparer community and make recommendations about the most effective means to ensure accurate and professional return preparation and oversight;</li> <li>◆ Require the Secretary of the Treasury to study the impact cross-marketing tax preparation services with other consumer products and services has on the accuracy of returns and tax compliance; and</li> <li>◆ Require the IRS to take steps within its existing administrative authority, including requiring a check-box on all returns in which preparers would enter their category of return preparer (i.e., attorney, CPA, enrolled agent, or unenrolled preparer) and developing a simple, easy-to-read pamphlet for taxpayers that explains their protections.</li> </ul>		
Legislative Activity 111th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
Legislative Activity 108th Congress	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006-Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006-Placed on Senate Legislative Calendar under General Orders; Calendar No. 614
	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
Legislative Activity 108th Congress	S 882	Baucus	4/10/2003	5/19/2004-S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

<b>Referrals to LITCs</b>					
National Taxpayer Advocate 2007 Annual Report to Congress 551-553.		Amend IRC § 7526(c) to add a special rule stating that notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section. This change will allow IRS employees to refer a taxpayer to a specific clinic for assistance.			
		<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 112th Congress		S 1573	Durbin	9/15/2011	Placed on the Senate Legislative Calendar under General Orders. Calendar No. 171
Legislative Activity 111th Congress		HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
		S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
		HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress		HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
<b>Public Awareness Campaign on Registration Requirements</b>					
National Taxpayer Advocate 2002 Annual Report to Congress 216-230.		Authorize the IRS to conduct a public information and consumer education campaign, utilizing paid advertising, to inform the public of the requirements that paid preparers must sign the return prepared for a fee and display registration cards.			
		<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress		S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
		HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress		HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
		S 1219	Bingaman	4/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress		HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
		S 832	Bingaman	4/18/2005	Referred to the Finance Committee
		S 1321	Santorum	6/28/2005	9/15/2006-Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with S. Rep. No. 109-336 9/15/2006-Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
Legislative Activity 108th Congress		S 685	Bingaman	3/21/2003	Referred to the Finance Committee
		S 882	Baucus	4/10/2003	5/19/2004-S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
		HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
<b>Increase Preparer Penalties</b>					
National Taxpayer Advocate 2003 Annual Report to Congress 270-301.		Strengthen oversight of all preparers by enhancing due diligence and signature requirements, increasing the dollar amount of preparer penalties, and assessing and collecting those penalties, as appropriate.			
Legislative Activity 112th Congress		<b>Pub. L. No. 112-41 § 501, 125 Stat. 428, 459 (2011).</b>			
		<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress		S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
		HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
Legislative Activity 110th Congress		HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
		HR 4318	Crowley/ Ramstad	12/6/2007	Referred to the Ways & Means Committee
		S 2851	Bunning	4/14/2008	Referred to the Finance Committee
		S 1219	Bingaman	4/25/2007	Referred to the Finance Committee

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

Legislative Activity 109th Congress	HR 894	Becerra	2/17/2005	Referred to the Financial Institutions and Consumer Credit Subcommittee
	S 832	Bingaman	4/18/2005	Referred to the Finance Committee
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Legislative Activity 108th Congress	S 685	Bingaman	3/21/2003	Referred to the Finance Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated into HR 1528 as an amendment and HR 1528 passed in lieu of S 882
	HR 3983	Becerra	3/17/2004	Referred to the Ways & Means Committee
<b>Refund Delivery Options</b> National Taxpayer Advocate 2008 Report to Congress 427 - 441.	Direct the Department of the Treasury and the IRS to (1) minimize refund turnaround times; (2) implement a Revenue Protection Indicator; (3) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs); and (4) conduct a public awareness campaign to disseminate accurate information about refund delivery options.			
Legislative Activity 111th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Senate Finance Committee
	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
<b>Small Business Issues</b>				
<b>Health Insurance Deduction/Self-Employed Individuals</b> National Taxpayer Advocate 2001 Annual Report to Congress 223. National Taxpayer Advocate 2008 Annual Report to Congress 388-389.	Allow self-employed taxpayers to deduct the costs of health insurance premiums for purposes of self-employment taxes.			
Legislative Activity 111th Congress	<b>Pub. L. No. 111-124, § 2041 STAT 2560 (2010).</b>			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 725	Bingaman	3/26/2009	Referred to the Finance Committee
	HR 1470	Kind	3/12/2009	Referred to the Ways & Means Committee
Legislative Activity 110th Congress	S 2239	Bingaman	10/25/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 663	Bingaman	3/17/2005	Referred to the Finance Committee
	S 3857	Smith	9/16/2006	Referred to the Finance Committee
Legislative Activity 108th Congress	HR 741	Sanchez	2/12/2003	Referred to the Ways & Means Committee
	HR 1873	Manzullo Velazquez	4/30/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	S 2130	Bingaman	4/15/2002	Referred to the Finance Committee
<b>Married Couples as Business Co-owners</b> National Taxpayer Advocate 2002 Annual Report to Congress 172-184.	Amend IRC § 761(a) to allow a married couple operating a business as co-owners to elect out of sub-chapter K of the IRC and file one Schedule C (or Schedule F in the case of a farming business) and two Schedules SE if certain conditions apply.			
Legislative Activity 110th Congress	<b>Pub.L. No. 110-28, Title VIII, § 8215, 121 Stat. 193, 194 (2007).</b>			
Legislative Activity 109th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in Senate, with an amendment
	S 842	Kerry	4/9/2003	Referred to the Finance Committee
	HR 1640	Udall	4/3/2003	Referred to the Ways & Means Committee
	HR 1558	Doggett	4/2/2003	Referred to the Ways & Means Committee
<b>Income Averaging for Commercial Fishermen</b> National Taxpayer Advocate 2001 Annual Report to Congress 226.	Amend IRC § 1301(a) to provide commercial fishermen the benefit of income averaging currently available to farmers.			
Legislative Activity 108th Congress	<b>Pub. L. No. 108-357, § 314, 118 Stat. 1468, 1469 (2004).</b>			
<b>Election to be treated as an S Corporation</b> National Taxpayer Advocate 2004 Annual Report to Congress 390-393.	Amend IRC § 1362(a) to allow a small business corporation to elect to be treated as an S corporation no later than the date it timely files (including extensions) its first Form 1120S, <i>U.S. Income Tax Return for an S Corporation</i> .			
Legislative Activity 109th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
Legislative Activity 109th Congress	HR 3841	Manzullo	9/2/2005	Referred to the Ways & Means Committee
	<b>Regulation of Payroll Tax Deposits Agents</b> National Taxpayer Advocate 2004 Annual Report to Congress 394-399.	Require payroll services to meet certain qualifications to protect businesses that use payroll service providers from tax deposit fund misappropriation or fraud.		
Legislative Activity 110th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 1773	Snowe	7/12/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 3583	Snowe	6/27/2006	Referred to the Finance Committee
	S 1321	Santorum	6/28/2005	9/15/2006–The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006–Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
<b>Simplification</b>				
<b>Reduce the Number of Tax Preferences</b> National Taxpayer Advocate 2010 Annual Report to Congress 365-372.	Simplify the complexity of the tax code generally by reducing the number of tax preferences.			
Legislative Activity 112th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 727	Wyden	4/5/2011	Referred to the Finance Committee
<b>Simplify and Streamline Education Tax Incentives</b> National Taxpayer Advocate 2008 Annual Report to Congress 370-372 National Taxpayer Advocate 2004 Annual Report to Congress 403-422	Enact reforms to simplify and streamline the education tax incentives by consolidating, creating uniformity among, or adding permanency to the various education tax incentives. Specifically, (1) incentives under § 25A should be consolidated with § 222 and possibly § 221, (2) the education provisions should be made more consistent regarding the relationship of the student to the taxpayer, (3) the definitions for “Qualified Higher Education Expenses” and “Eligible Education Institution” should be simplified, (4) the income level and phase-out calculations should be more consistent under the various provisions, (5) all dollar amounts should be indexed for inflation, and (6) after initial use of sunset provisions and simplification amendments, the incentives should be made permanent.			
Legislative Activity 112th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 727	Wyden	4/5/2011	Referred to the Finance Committee

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

<b>Simplify and Streamline Retirement Savings Tax Incentives</b>																									
National Taxpayer Advocate 2008 Annual Report to Congress 373-374 National Taxpayer Advocate 2004 Annual Report to Congress 423-432	Consolidate existing retirement incentives, particularly where the differences in plan attributes are minor. For instance, Congress should consider establishing one retirement plan for individual taxpayers, one for plans offered by small businesses, and one suitable for large businesses and governmental entities (eliminating plans that are limited to governmental entities). At a minimum, Congress should establish uniform rules regarding hardship withdrawals, plan loans, and portability.																								
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<b>Tax Gap Provisions</b>																									
<b>Corporate Information Reporting</b>																									
National Taxpayer Advocate 2008 Annual Report to Congress 388.	Require businesses that pay \$600 or more during the year to non-corporate and corporate service providers to file an information report with each provider and with the IRS. Information reporting already is required on payments for services to non-corporate providers. This applies to payments made after December 31, 2011.																								
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<b>Reporting on Customer's Basis in Security Transaction</b>																									
National Taxpayer Advocate 2005 Annual Report to Congress 433-441.	Require brokers to keep track of an investor's basis, transfer basis information to a successor broker if the investor transfers the stock or mutual fund holding, and report basis information to the taxpayer and the IRS (along with the proceeds generated by a sale) on Form 1099-B.																								
Legislative Activity 110th Congress	<b>Pub. L. No. 110-343, § 403, 121 Stat. 3854, 3855 (2008).</b>																								
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<b>IRS Forms Revisions</b>																									
National Taxpayer Advocate 2004 Annual Report to Congress 480. National Taxpayer Advocate 2010 Annual Report to Congress 40.	Revise Form 1040, Schedule C, to include a line item showing the amount of self-employment income that was reported on Forms 1099-MISC.																								
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<b>IRS to Promote Estimated Tax Payments Through the Electronic Federal Tax Payment System (EFTPS)</b>																									
National Taxpayer Advocate 2005 Annual Report to Congress 381-396.	Amend IRC § 6302(h) to require the IRS to promote estimated tax payments through EFTPS and establish a goal of collecting at least 75 percent of all estimated tax payment dollars through EFTPS by fiscal year 2012.																								
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## National Taxpayer Advocate Legislative Recommendations with Congressional Action

<p><b>Study of Use of Voluntary Withholding Agreements</b></p> <p>National Taxpayer Advocate 2004 Annual Report to Congress 478-489; National Taxpayer Advocate 2005 Annual Report to Congress 381-396.</p>	Amend IRC § 3402(p)(3) to specifically authorize voluntary withholdings agreements between independent contractors and service-recipients as defined in IRC § 6041A(a)(1).			
Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006-The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336. 9/15/2006-Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
<p><b>Require Form 1099 Reporting for Incorporated Service Providers</b></p> <p>National Taxpayer Advocate 2007 Report to Congress 494-496.</p>	Require service recipients to issue Forms 1099-MISC to incorporated service providers and increase the penalties for failure to comply with the information reporting requirements.			
Legislative Activity 111th Congress	<p><b>Pub. L No. 111-148 § 9006 (2010).</b></p> <p>However, this Act also contains a reporting requirement for goods sold, which the National Taxpayer Advocate opposes because of the enormous burden it places on businesses. See Legislative Recommendation: Repeal the Information Reporting Requirement for Purchases of Goods over \$600, but Require Reporting on Corporate and Certain Other Payments, infra.</p>			
<p><b>Require Financial Institutions to Report All Accounts to the IRS by Eliminating the \$10 Threshold on Interest Reporting</b></p> <p>National Taxpayer Advocate 2007 Report to Congress 501-502.</p>	Eliminate the \$10 interest threshold beneath which financial institutions are not required to file Form 1099-INT reports with the IRS.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<p><b>Revise Form 1040, Schedule C to break out gross receipts reported on payee statements such as Form 1099</b></p> <p>National Taxpayer Advocate 2007 Report to Congress 40.</p>	Administrative recommendation that the IRS add a line to Schedule C so that taxpayers would separately report the amount of income reported to them on Forms 1099 and other income not reported on Forms 1099. If enacted by statute, the IRS would be required to implement this recommendation.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<p><b>Include a Checkbox on Business Returns Requiring Taxpayers to Verify that they Filed all Required Forms 1099</b></p> <p>National Taxpayer Advocate 2007 Report to Congress 40.</p>	Administrative recommendation that the IRS require all businesses to answer two questions on their income tax returns: "Did you make any payments over \$600 in the aggregate during the year to any unincorporated trade or business?" and "If yes, did you file all required Forms 1099?" S 3795 would require the IRS to study whether placing a checkbox or similar indicator on business tax returns would affect voluntary compliance.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<p><b>Authorize Voluntary Withholding Upon Request</b></p> <p>National Taxpayer Advocate 2007 Report to Congress 493-494.</p>	Authorize voluntary withholding agreements between independent contractors and service recipients.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

<b>Require Backup Withholding on Certain Payments When TINs Cannot Be Validated</b> National Taxpayer Advocate 2005 Report to Congress 238-248.	Administrative recommendation that the IRS require payors to commence backup withholding if they do not receive verification of a payee's TIN. (S. 3795 would require voluntary withholding on certain payments.)			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<b>Worker Classification</b> National Taxpayer Advocate 2008 Annual Report to Congress 375-390.	Direct Treasury and the Joint Committee on Taxation to report on the operation of the revised worker classification rules and provide recommendations to increase compliance.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
<b>Taxpayer Bill of Rights and <i>De Minimis</i> "Apology" Payments</b>				
<b>Taxpayer Bill of Rights</b> National Taxpayer Advocate 2007 Report to Congress 486-489.	Enact a Taxpayer Bill of Rights setting forth the fundamental rights and obligations of U.S. taxpayers.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Ways & Means Committee
	HR 5047	Becerra	4/15/2010	Referred to the Finance Committee
Legislative Activity 110th Congress	HR 5716	Becerra	4/8/2008	Referred to the Ways & Means Committee
<b><i>De Minimis</i> "Apology" Payments</b> National Taxpayer Advocate 2007 Report to Congress 490.	Grant the National Taxpayer Advocate the discretionary, nondelegable authority to provide <i>de minimis</i> compensation to taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer and the taxpayer meets the IRC § 7811 definition of significant hardship.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	S 3795	Carper	9/16/2010	Referred to the Finance Committee
<b>Simplify the Tax Treatment of Cancellation of Debt Income</b>				
<b>Simplify the Tax Treatment of Cancellation of Debt Income</b> National Taxpayer Advocate 2008 Report to Congress 391-396.	Enact one of several proposed alternatives to remove taxpayers with modest amounts of debt cancellation from the cancellation of debt income regime.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress	HR 4561	Lewis	2/2/2010	Referred to the Ways & Means Committee
<b>Joint and Several Liability</b>				
<b>Tax Court Review of Request for Equitable Innocent Spouse Relief</b> National Taxpayer Advocate 2001 Annual Report to Congress 128-165.	Amend IRC § 6015(e) to clarify that taxpayers have the right to petition the Tax Court to challenge determinations in cases seeking relief under IRC § 6015(f) alone.			
Legislative Activity 109th Congress	<b>Pub. L. No. 109-432, § 408, 120 Stat. 3061, 3062 (2006).</b>			
<b>Collection Issues</b>				
<b>Improve Offer In Compromise Program Accessibility</b> National Taxpayer Advocate 2006 Annual Report to Congress 507-519.	Repeal the partial payment requirement, or if repeal is not possible, (1) provide taxpayers with the right to appeal to the IRS Appeals function the IRS's decision to return an offer without considering it on the merits; (2) reduce the partial payment to 20 percent of current income and liquid assets that could be disposed of immediately without significant cost; and (3) create an economic hardship exception to the requirement.			

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

	Bill Number	Sponsor	Date	Status
Legislative Activity 112th Congress	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 111th Congress	HR 4994	Lewis	4/13/2010	Referred to the Ways & Means Committee
	HR 2342	Lewis	5/12/2009	Referred to the Ways & Means Committee
<b>Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens</b> 2009 National Taxpayer Advocate Report to Congress 357-364.	Provide clear and specific guidance about the factors the IRS must consider when filing a Notice of Federal Tax Lien (NFL) and amend the Fair Credit Reporting Act to set specific timeframes for reporting derogatory tax lien information on credit reports.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
	HR 6439	Hastings	11/18/2010	Referred to the Ways & Means Committee
<b>Return of Levy or Sale Proceeds</b> National Taxpayer Advocate 2001 Annual Report to Congress 202-214.	Amend IRC § 6343(b) to extend the period of time within which a third party can request a return of levied funds or the proceeds from the sale of levied property from nine months to two years from the date of levy. This amendment would also extend the period of time available to taxpayers under IRC § 6343(d) within which to request a return of levied funds or sale proceeds.			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
	HR 1677	Rangel	3/26/2007	Referred to the Finance Committee
Legislative Activity 109th Congress	S 1321 RS	Santorum	6/28/2005	9/15/2006-The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title. With written report No. 109-336 9/15/2006-Placed on the Senate Legislative Calendar under General Orders. Calendar No. 614
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004-Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in House
	HR 586	Lewis	2/13/2001	4/18/02-Passed the House with an amendment; referred to the Senate
<b>Reinstatement of Retirement Accounts</b> National Taxpayer Advocate 2001 Annual Report to Congress 202-214.	Amend the following IRC sections to allow contributions to individual retirement accounts and other qualified plans from the funds returned to the taxpayer or to third parties under IRC § 6343: <ul style="list-style-type: none"> <li>◆ § 401 - Qualified Pension, Profit Sharing, Keogh, and Stock Bonus Plans</li> <li>◆ § 408 - Individual Retirement Account, and SEP-Individual Retirement Account</li> <li>◆ § 408A - Roth Individual Retirement Account</li> </ul>			
	Bill Number	Sponsor	Date	Status
Legislative Activity 110th Congress	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee
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National Taxpayer Advocate Legislative Recommendations with Congressional Action

Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	S 882	Baucus	4/10/2003	5/19/2004–S 882 was incorporated in H.R. 1528 through an amendment and HR 1528 passed in lieu of S 882
Legislative Activity 107th Congress	HR 586	Lewis	2/13/2001	4/18/2002–Passed the House with an amendment; referred to Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
<b>Consolidation of Appeals of Collection Due Process (CDP) Determinations</b>				
National Taxpayer Advocate 2004 Annual Report to Congress 451-470.	Consolidate judicial review of CDP hearings in the United States Tax Court, clarify the role and scope of Tax Court oversight of Appeals' continuing jurisdiction over CDP cases, and address the Tax Court's standard of review for the underlying liability in CDP cases.			
Legislative Activity 109th Congress	<b>Pub. L. No. 109-280, § 855, 120 Stat. 1019 (2006).</b>			
<b>Partial Payment Installment Agreements</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 210-214.	Amend IRC § 6159 to allow the IRS to enter into installment agreements that do not provide for full payment of the tax liability over the statutory limitations period for collection of tax where it appears to be in the best interests of the taxpayer and the IRS.			
Legislative Activity 108th Congress	<b>Pub. L. No. 108-357, § 833, 118 Stat. 1589-1592 (2004).</b>			
<b>Penalties and Interest</b>				
<b>Interest Rate and Failure to Pay Penalty</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 179-182.	Repeal the failure to pay penalty provisions of IRC § 6651 while revising IRC § 6621 to allow for a higher underpayment interest rate.			
Legislative Activity 108th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
<b>Interest Abatement on Erroneous Refunds</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 183-187.	Amend IRC § 6404(e)(2) to require the Secretary to abate the assessment of all interest on any erroneous refund under IRC § 6602 until the date the demand for repayment is made, unless the taxpayer (or a related party) has in any way caused such an erroneous refund. Further, the Secretary should have discretion not to abate any or all such interest where the Secretary can establish that the taxpayer had notice of the erroneous refund before the date of demand and the taxpayer did not attempt to resolve the issue with the IRS within 30 days of such notice.			
Legislative Activity 109th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	HR 726	Sanchez	2/9/2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
<b>First Time Penalty Waiver</b>				
National Taxpayer Advocate 2001 Annual Report to Congress 188-192.	Authorize the IRS to provide penalty relief for first-time filers and taxpayers with excellent compliance histories who make reasonable attempts to comply with the tax rules.			
Legislative Activity 108th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	HR 1528	Portman	6/20/2003	5/19/2004–Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
Legislative Activity 107th Congress	HR 3991	Houghton	3/19/2002	Defeated in the House

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

<b>Federal Tax Deposit (FTD) Avoidance Penalty</b> National Taxpayer Advocate 2001 Annual Report to Congress 222.	Reduce the maximum FTD penalty rate from ten to two percent for taxpayers who make deposits on time but not in the manner prescribed in the IRC.			
Legislative Activity 109th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	HR 3629	Doggett	7/29/2005	Referred to the Ways & Means Committee
	HR 3841	Manzullo	9/2//2005	Referred to the Ways & Means Committee
Legislative Activity 108th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006-The Finance Committee. Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006-Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
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	HR 1528	Portman	6/20/2003	5/19/2004-Passed/agreed to in the Senate, with an amendment
Legislative Activity 107th Congress	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
	HR 586	Lewis	2/13/2001	4/18/2002-Passed the House with an amendment; referred to the Senate
	HR 3991	Houghton	3/19/2002	Defeated in the House
<b>Family Issues</b>				
<b>Uniform Definition of a Qualifying Child</b> National Taxpayer Advocate 2001 Annual Report to Congress 78-100.	Create a uniform definition of "qualifying child" applicable to tax provisions relating to children and family status.			
Legislative Activity 108th Congress	<b>Pub. L. No. 108-311, § 201, 118 Stat. 1169-1175 (2004).</b>			
<b>Means Tested Public Assistance Benefits</b> National Taxpayer Advocate 2001 Annual Report to Congress 76-127.	Amend the IRC §§ 152, 2(b) and 7703(b) to provide that means-tested public benefits are excluded from the computation of support in determining whether a taxpayer is entitled to claim the dependency exemption and from the cost of maintenance test for the purpose of head-of-household filing status or "not married" status.			
Legislative Activity 108th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	HR 22	Houghton	1/3/2003	Referred to the Ways & Means Committee
<b>Credits for the Elderly or the Permanently Disabled</b> National Taxpayer Advocate 2001 Annual Report to Congress 218-219.	Amend IRC § 22 to adjust the income threshold amount for past inflation and provide for future indexing for inflation.			
Legislative Activity 107th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 2131	Bingaman	4/15/2002	Referred to the Finance Committee
<b>Electronic Filing Issues</b>				
<b>Direct Filing Portal</b> National Taxpayer Advocate 2004 Annual Report to Congress 471-477.	Amend IRC § 6011(f) to require the IRS to post fill-in forms on its website and make electronic filing free to all individual taxpayers.			
Legislative Activity 112th Congress	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 1289	Carper	6/28/2011	Referred to the Finance Committee
Legislative Activity 110th Congress	S 1074	Akaka	3/29/2007	Referred to the Finance Committee
	HR 5801	Lampson	4/15/2008	Referred to the Ways & Means Committee

## National Taxpayer Advocate Legislative Recommendations with Congressional Action

Legislative Activity 109th Congress	S 1321RS	Santorum	6/28/2005	9/15/2006-Referred to the Finance Committee; Reported by Senator Grassley with an amendment in the nature of a substitute and an amendment to the title; with written report No. 109-336 9/15/2006-Placed on the Senate Legislative Calendar under General Orders; Calendar No. 614
<b>Free Electronic Filing For All Taxpayers</b> National Taxpayer Advocate 2004 Annual Report to Congress 471-477.	Revise IRC § 6011(f) to provide that the Secretary shall make electronic return preparation and electronic filing available without charge to all individual taxpayers.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 110th Congress	S 2861	Schumer	4/15/2008	Referred to the Finance Committee
<b>Office of the Taxpayer Advocate</b>				
<b>Confidentiality of Taxpayer Communications</b> National Taxpayer Advocate 2002 Annual Report to Congress 198-215.	Strengthen the independence of the National Taxpayer Advocate and the Office of the Taxpayer Advocate by amending IRC §§ 7803(c)(3) and 7811. Amend IRC § 7803(c)(4)(A)(iv) to clarify that, notwithstanding any other provision of the IRC, Local Taxpayer Advocates have the discretion to withhold from the IRS the fact that a taxpayer contacted the Taxpayer Advocate Service or any information provided by a taxpayer to TAS.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	5/19/2004-Passed/agreed to in the Senate, with an amendment
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
<b>Access to Independent Legal Counsel</b> National Taxpayer Advocate 2002 Annual Report to Congress 198-215.	Amend IRC § 7803(c)(3) to provide for the position of Counsel to the National Taxpayer Advocate, who shall advise the National Taxpayer Advocate on matters pertaining to taxpayer rights, tax administration, and the Office of Taxpayer Advocate, including commenting on rules, regulations, and significant procedures, and the preparation of <i>amicus</i> briefs.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 108th Congress	HR 1528	Portman	6/20/2003	Referred to the Senate
	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
<b>Taxpayer Advocate Directive</b> National Taxpayer Advocate 2002 Report to Congress 419-422.	Amended IRC § 7811 to provide the National Taxpayer Advocate with the non-delegable authority to issue a Taxpayer Advocate Directive to the Internal Revenue Service with respect to any program, proposed program, action, or failure to act that may create a significant hardship for a taxpayer segment or taxpayers at large.			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
Legislative Activity 111th Congress	S 3215	Bingaman	4/15/2010	Referred to the Finance Committee
	HR 5047	Becerra	4/15/2010	Referred to the Ways & Means Committee
<b>Other Issues</b>				
<b>Modify Internal Revenue Code Section 6707A to Ameliorate Unconscionable Impact</b> National Taxpayer Advocate 2008 Annual Report to Congress 419-422.	Modify IRC § 6707A to ameliorate unconscionable impact. Section 6707A of the IRC imposes a penalty of \$100,000 per individual per year and \$200,000 per entity per year for failure to make special disclosures of a "listed transaction."			
Legislative Activity 111th Congress	<b>Pub. L. No. 111-124, § 2041 Stat. 2560 (2010).</b>			
	<b>Bill Number</b>	<b>Sponsor</b>	<b>Date</b>	<b>Status</b>
	S 2771	Baucus	11/16/2009	Referred to the Finance Committee
	HR 4068	Lewis	11/16/2009	Referred to the Ways & Means Committee
	S 2917	Baucus	12/18/2009	Referred to the Finance Committee

National Taxpayer Advocate Legislative Recommendations with Congressional Action

<p><b>Eliminate Tax Strategy Patents</b> National Taxpayer Advocate 2007 Annual Report to Congress 512-524.</p>	<p>Bar tax strategy patents, which increase compliance costs and undermine respect for congressionally-created incentives, or require the PTO to send any tax strategy patent applications to the IRS so that abuse can be mitigated.</p>																
<p>Legislative Activity 112th Congress</p>	<p><b>Pub. L. No. 112-29 § 14(a), 125 Stat. 284, 327 (2011).</b></p>																
<p><b>Disclosure Regarding Suicide Threats</b> National Taxpayer Advocate 2001 Annual Report to Congress 227.</p>	<p>Amend IRC § 6103(i)(3)(B) to allow the IRS to contact and provide necessary return information to specified local law enforcement agencies and local suicide prevention authorities, in addition to federal and state law enforcement agencies in situations involving danger of death or physical injury.</p>																
<p>Legislative Activity 112th Congress</p>	<table border="1"> <thead> <tr> <th>Bill Number</th> <th>Sponsor</th> <th>Date</th> <th>Status</th> </tr> </thead> <tbody> <tr> <td>HR 1528</td> <td>Portman</td> <td>6/20/2003</td> <td>5/19/2004—Passed/agreed to in the Senate, with an amendment</td> </tr> <tr> <td>S 882</td> <td>Baucus</td> <td>4/10/2003</td> <td>5/19/2004—S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882</td> </tr> <tr> <td>HR 1661</td> <td>Rangel</td> <td>4/8/2003</td> <td>Referred to the Ways &amp; Means Committee</td> </tr> </tbody> </table>	Bill Number	Sponsor	Date	Status	HR 1528	Portman	6/20/2003	5/19/2004—Passed/agreed to in the Senate, with an amendment	S 882	Baucus	4/10/2003	5/19/2004—S 882 was incorporated in HR 1528 through an amendment and HR 1528 passed in lieu of S 882	HR 1661	Rangel	4/8/2003	Referred to the Ways & Means Committee
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<p><b>Attorney Fees</b> National Taxpayer Advocate 2002 Annual Report to Congress 161-171.</p>	<p>Allow successful plaintiffs in nonphysical personal injury cases who must include legal fees in gross income to deduct the fees “above the line.” Thus, the net tax effect would not vary depending on the state in which a plaintiff resides.</p>																
<p>Legislative Activity 108th Congress</p>	<p><b>Pub. L. No. 108-357, § 703, 118 Stat. 1546-1548 (2004).</b></p>																
<p><b>Attainment of Age Definition</b> National Taxpayer Advocate 2003 Annual Report to Congress 308-311.</p>	<p>Amend IRC § 7701 by adding a new subsection as follows: “Attainment of Age. An individual attains the next age on the anniversary of his date of birth.”</p>																
<p>Legislative Activity 108th Congress</p>	<table border="1"> <thead> <tr> <th>Bill Number</th> <th>Sponsor</th> <th>Date</th> <th>Status</th> </tr> </thead> <tbody> <tr> <td>HR 4841</td> <td>Burns</td> <td>7/15/2004</td> <td>7/21/2004—Passed the House; 7/22/2004—Received in the Senate</td> </tr> </tbody> </table>	Bill Number	Sponsor	Date	Status	HR 4841	Burns	7/15/2004	7/21/2004—Passed the House; 7/22/2004—Received in the Senate								
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HR 4841	Burns	7/15/2004	7/21/2004—Passed the House; 7/22/2004—Received in the Senate														
<p><b>Home-Based Service Workers (HBSW)</b> National Taxpayer Advocate 2001 Annual Report to Congress 193-201.</p>	<p>Amend IRC § 3121(d) to clarify that HBSWs are employees rather than independent contractors.</p>																
<p>Legislative Activity 110th Congress</p>	<table border="1"> <thead> <tr> <th>Bill Number</th> <th>Sponsor</th> <th>Date</th> <th>Status</th> </tr> </thead> <tbody> <tr> <td>HR 5719</td> <td>Rangel</td> <td>4/16/2008</td> <td>Referred to the Finance Committee</td> </tr> </tbody> </table>	Bill Number	Sponsor	Date	Status	HR 5719	Rangel	4/16/2008	Referred to the Finance Committee								
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## Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights

### PROBLEM

Over the last decade, the National Taxpayer Advocate has recommended many legislative changes that would serve to protect taxpayer rights. At a time when the IRS budget is shrinking, and resources are shifting to enforcement in order to increase revenue, taxpayer rights must be a priority.<sup>1</sup>

In addition to a declining budget, the IRS is faced with a taxpayer base that is increasingly diverse and has differing needs, education levels, income levels, and basic understandings of the tax system.<sup>2</sup> The results of a recent survey of taxpayers regarding their understanding of their rights provide insight into the need for Congress to both enumerate and further protect the rights of taxpayers. When asked if they believed they had rights before the IRS, 55 percent of taxpayers responded “No.”<sup>3</sup> Further, when asked if they knew what their rights were, 61 percent responded “No” or “Not Sure.”<sup>4</sup> As discussed in the Most Serious Problem *Introduction to Diversity Issues: The IRS Should Do More to Accommodate Changing Taxpayer Demographics*, *supra*, differing taxpayer income levels, education levels, and needs underscore the importance of a clear and concise statement of taxpayer rights accessible to all taxpayers.

Congress has not passed a major piece of legislation addressing taxpayer rights since the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98).<sup>5</sup> During that time, both the House and the Senate have introduced various bills that incorporate the Taxpayer Bill of Rights (TBOR) proposed by the National Taxpayer Advocate in 2007.<sup>6</sup> However, in that same intervening 13-year period Congress has enacted over 140 new pieces of tax legislation incorporating about 5,000 changes to the tax code.<sup>7</sup>

The current budget situation for the IRS is much like the climate at the time leading up to RRA 98. In a report to the IRS Oversight Board, former IRS Commissioner Charles Rossotti described the economic situation facing the IRS in the years prior to RRA 98: “Budget and staff cuts, rapid economic growth and the shift in the tax base from

<sup>1</sup> See Most Serious Problems: *Introduction to Revenue Protection Issues: As the IRS Relies More Heavily on Automation to Strengthen Enforcement, There Is Increased Risk It Will Assume Taxpayers Are Cheating, Confuse Taxpayers About Their Rights, and Sidestep Longstanding Taxpayer Protections*, *supra*, and *The IRS Is Not Adequately Funded to Serve Taxpayers and Collect Taxes*, *supra*, for a discussion of the impact of the dual pressures of budget constraints and expanding responsibilities on taxpayer rights.

<sup>2</sup> See Most Serious Problem *Introduction to Diversity Issues: The IRS Should Do More to Accommodate Changing Taxpayer Demographics*, *supra*.

<sup>3</sup> Forrester Omnibus Mail Survey for the Taxpayer Advocate Service (Nov. 2011).

<sup>4</sup> *Id.*

<sup>5</sup> RRA 98, Pub. L. No. 105-206, 112 Stat. 685 (1998).

<sup>6</sup> See S. 3215, 111th Cong. (2010); H.R. 5047, 111th Cong. (2010); H.R. 5716, 110th Cong. (2008). See also National Taxpayer Advocate 2007 Annual Report to Congress 478-489.

<sup>7</sup> CCH Database, *Acts Supplementing the 1986 Code*, Nov. 16, 2011. Including all legislation enacted through Nov. 16, 2011.

middle-income wage earners and domestic corporations to upper-income entrepreneurs, passthrough entities and global corporations, all contributed to a diminished capacity to cope with service and compliance demands.”<sup>8</sup> These factors and more led to a situation where the IRS attempted to justify a larger budget by focusing on enforcement and revenue raising.<sup>9</sup> With a continuing budget situation similar to this one, Congress should act proactively to protect taxpayers in order to prevent a recurrence of events that brought about RRA 98. In a time when the IRS will feel pressure to bring in additional tax revenue, it is crucial to provide taxpayers with strong protections for their rights.

## RECOMMENDATION

The National Taxpayer Advocate urges Congress to enact the legislative recommendations detailed in previous annual reports, beginning with the 2007 recommendation to codify a taxpayer bill of rights (TBOR) that would explicitly detail the rights and responsibilities of taxpayers.<sup>10</sup> The rights and responsibilities enumerated in the proposed TBOR are:

### *Taxpayer rights:*

- Right to be Informed;
- Right to be Assisted;
- Right to be Heard;
- Right to pay no more than the correct amount of tax;
- Right of Appeal;
- Right to Certainty;
- Right to Privacy;
- Right to Confidentiality;
- Right to Representation; and
- Right to Fair and Just Tax System.

### *Taxpayer responsibilities:*

- Obligation to be honest;
- Obligation to be cooperative;
- Obligation to provide accurate information and documents on time;
- Obligation to keep records; and
- Obligation to pay taxes on time.

<sup>8</sup> Commissioner Charles O. Rossotti, *Report to the IRS Oversight Board: Assessment of the IRS and the Tax System 3* (Sept. 2002).

<sup>9</sup> *Id.*

<sup>10</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 478-489. Legislative activity incorporating this recommendation in whole or in part: S. 3215, 111th Cong. (2010); H.R. 5047, 111th Cong. (2010); H.R. 5716, 110th Cong. (2008).

## EXPLANATION OF RECOMMENDATION

Taxpayers are entitled to all of the rights and are obligated to conform with all of the responsibilities outlined in the proposed TBOR. The TBOR would codify those rights and responsibilities in one place and make it clear to taxpayers what those rights and responsibilities are. In Appendix I, we cross-reference these rights and responsibilities to current laws and regulations.

In making this recommendation, the National Taxpayer Advocate intends that taxpayers will be able to see their rights and responsibilities codified, the principles of which already form a basis for existing laws, regulations, and other sources of authority where those rights and responsibilities are impacted. Additionally, Congress should strengthen the already existing rights by enacting the previously recommended legislative changes detailed below. The National Taxpayer Advocate firmly believes that enacting these additional protections and making it clear to taxpayers what their rights and responsibilities include will enable taxpayers to avail themselves of the protections to which they are entitled and enhance taxpayer compliance. Moreover, a codified TBOR will help ensure that the IRS will continue to treat taxpayers fairly, properly, and with empathy.

The following discussion summarizes the proposals made in previous Annual Reports to Congress as they relate to the taxpayer rights enumerated in the 2007 TBOR recommendation.

### The Right to Be Informed

Currently, the right to be informed is provided to taxpayers in the Internal Revenue Code (IRC) and other federal laws.<sup>11</sup> Taxpayers have the right to know what is expected of them in terms of complying with the tax law. Taxpayers also have the right to have access to IRS procedures, policies, guidance, and other instructions to staff, to the extent permitted by law. This right includes protections and procedures under the Freedom of Information Act (FOIA),<sup>12</sup> the Privacy Act,<sup>13</sup> and IRC § 6110. It also includes clear explanations of the law and IRS procedures, in the form of tax forms and instructions, publications, notices, and correspondence, as well as oral communications. Taxpayers also have the right to be informed of the results of, and reasons for, IRS decisions about their tax matters. Enactment of the following previously recommended legislative changes would enhance the right of taxpayers to be informed.

- **Mailing Duplicate Notices to Credible Alternate Addresses.**<sup>14</sup> IRS notices often trigger the legal rights and obligations of taxpayers to take critical actions, such as contest

<sup>11</sup> See, e.g., IRC § 7521(b)(1); IRC § 7522; IRC § 6751; RRA 98 § 3501; RRA 98 § 3506. See also Publication 5, *Your Appeals Rights and How To Prepare a Protest If You Don't Agree*.

<sup>12</sup> 5 U.S.C. § 552.

<sup>13</sup> 5 U.S.C. § 552a.

<sup>14</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 449-451.

a liability, challenge a notice of deficiency, or contest a lien filing, and most require the taxpayer to take the action within a specified number of days. The IRS mails these notices to the taxpayer's last known address. However, with a mobile and transitory population, the last known address contained in the IRS's Master File (typically the address shown on the most recent return) may not reflect the taxpayer's current residence.<sup>15</sup> As a result, taxpayers who are between tax return filing seasons and have not updated their addresses with the IRS or the U.S. Postal Service may not receive critical notices from the IRS. The National Taxpayer Advocate recommends that Congress direct the Secretary of the Treasury to develop procedures for checking third-party databases for credible alternate addresses prior to sending notices that establish legal rights and obligations, and when there is a credible alternate address, in addition to the notice sent to the last known address, require the IRS to mail dual confirmation letters to credible alternate addresses.<sup>16</sup>

- **Notice of Right to Collection Due Process Hearing.**<sup>17</sup> The IRS often grants extra time for those outside the United States to file other documents or respond to inquiries where important procedural rights are involved.<sup>18</sup> However, a taxpayer submitting a Collection Due Process (CDP) request from outside the country does not have this additional time. These taxpayers experience an additional burden in gathering pertinent documents and allowing for the processing and delivery of foreign mail. This exhausts a significant portion of their 30-day CDP filing window, which can result in late filing and the loss of their ability to pursue a judicial remedy. We recommend that Congress amend IRC §§ 6320 (a)(2)(B) and 6330(a)(2) and (a)(3)(B) as necessary to provide the taxpayer outside the United States an additional 30-day period to request a hearing in response to a CDP notice, and amend IRC § 6330(d)(1) to allow an additional 30-day response period to taxpayers appealing a CDP determination from outside the United States.<sup>19</sup>

### The Right to Be Assisted

Taxpayers have the right to receive prompt, courteous, and professional assistance about tax obligations, in the manner in which they are best able to understand it, and to be provided a method to lodge grievances when service is inadequate. Taxpayers have a right to expect that the tax system will attempt to keep taxpayer compliance costs at a minimum, and that assistance will be available in a timely and accessible manner and without unreasonable delays. The right of taxpayers to be assisted is articulated in the IRS mission

<sup>15</sup> See Most Serious Problem *Introduction to Diversity Issues: The IRS Should Do More to Accommodate Changing Taxpayer Demographics*, *supra*.

<sup>16</sup> IRS Office of Chief Counsel Memorandum, Ref. No. PRESP-116879-09, *Use of Dual Confirmation Letters for Address Changes of Form 941 Filers Who Use Reporting Agents or Other Third Parties* (Aug. 19, 2009).

<sup>17</sup> See National Taxpayer Advocate 2002 Annual Report to Congress 244.

<sup>18</sup> See, e.g., IRC § 6213(a) (150 days instead of the usual 90 days to petition the United States Tax Court if the notice of deficiency is addressed to a taxpayer outside the United States).

<sup>19</sup> Although the 2002 recommendation only addressed IRC § 6330, which governs hearings before levies, a similar change should be made to IRC § 6320, which governs hearings upon filing of notices of lien, so that the time periods for requesting hearings in the lien and levy context are identical.

statement<sup>20</sup> and in RRA 98.<sup>21</sup> Enacting the following previously recommended legislative changes would strengthen the right of taxpayers to be assisted by the IRS.

- **Refund Delivery Options.**<sup>22</sup> Particularly in light of the current downturn in the economy, federal tax refunds are an important source of funds for many individual taxpayers. As a result, the Department of the Treasury and the IRS need to provide all taxpayers with the ability to receive refunds as quickly and inexpensively as possible. The National Taxpayer Advocate recommends that Congress direct Treasury and the IRS to (1) develop a program to enable unbanked taxpayers to receive refunds on stored value cards (SVCs)<sup>23</sup>; and (2) conduct a public awareness campaign to give taxpayers accurate information about refund delivery options, including information about average turnaround times for lower cost and government-sponsored options.<sup>24</sup>
- **Free Basic Electronic Return Preparation and Filing.**<sup>25</sup> In 1998, Congress directed the IRS to work toward a goal of having 80 percent of all returns filed electronically by 2007.<sup>26</sup> This is a desirable goal because e-filing benefits taxpayers and the IRS alike. However, while self-preparing paper returns is free for taxpayers, e-filing may require them to pay two separate fees to a vendor — one for preparing the return electronically, plus a second fee for filing it electronically. In 2002, the IRS entered into a three-year agreement with the Free File Alliance to provide free e-filing to at least 60 percent of all taxpayers. The IRS has contractually extended its agreement with the Free File Alliance through October 30, 2014. In addition, starting in 2009, taxpayers have the option to use Free File Fillable Forms, a free federal tax preparation and e-file service available to all taxpayers regardless of income. We recommend that Congress take the next step by requiring the IRS to modify its agreement with the Free File Alliance to permit the annual evaluation of, and potential modification to, the Free File Fillable Forms program specifications.<sup>27</sup> The IRS should have the authority to determine which

<sup>20</sup> “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.” IRM 1.1.1.1(1) (Mar. 1, 2006).

<sup>21</sup> See RRA 98 § 1002; RRA 98 § 3705; RRA 98 § 3709.

<sup>22</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 427-441. Legislative activity incorporating this recommendation in whole or in part: S. 3215, 111th Cong. (2010); H.R. 5047 111th Cong. (2010); H.R. 4994, 111th Cong. (2010).

<sup>23</sup> The Treasury Department launched a debit card pilot program during the 2011 filing season to issue refunds via prepaid cards to up to 800,000 unbanked taxpayers. After analyzing the preliminary results of the pilot, Treasury decided to discontinue the program due to low participation rates. Eric Kroh, *Treasury Won’t Renew Debit Card Refund Program in 2012, Spokesman Confirms*, Tax Notes Today (November 1, 2011). Despite low participation in the pilot as designed, the National Taxpayer Advocate believes it is in the best interest of taxpayers and tax administration to make a government-sponsored debit card available on a nationwide basis. Thus, the IRS should evaluate the methodology of the pilot, with a particular focus on the marketing campaign, to develop a more effective marketing strategy for a future government-sponsored debit card program.

<sup>24</sup> See Most Serious Problem: *After Refund Anticipation Loans: Taxpayers Will Benefit from Improved Education About Refund Delivery Options and the Availability of a Government-Sponsored Debit Card*, *supra*.

<sup>25</sup> See National Taxpayer Advocate 2004 Annual Report to Congress 471-477. Legislative activity incorporating this recommendation in whole or in part: S. 1289, 112th Congress (2011), S. 2861 110th Cong. (2008); H.R. 5801 110th Cong. (2008); S. 1074 110th Cong. (2007); S. 1321, 109th Cong. (2005).

<sup>26</sup> RRA 98 § 2001(a)(2). In 2007, the IRS Oversight Board “approved a revised and expanded goal in 2007 that calls for 80 percent of all major individual, business, and tax exempt returns to be electronically filed by 2012.” IRS Oversight Board Electronic Filing 2011 Annual Report to Congress 3.

<sup>27</sup> See Fifth Memorandum of Understanding on Service Standards and Disputes Between the Internal Revenue Service and Free File Alliance, LLC (Oct. 20, 2009), available at [http://www.irs.gov/pub/irs-utl/signed\\_fifth\\_mou\\_between\\_irs\\_and\\_ffa.pdf](http://www.irs.gov/pub/irs-utl/signed_fifth_mou_between_irs_and_ffa.pdf) (last visited Dec. 8, 2011).

forms and worksheets must be included in the program each year as well as other features to meet the evolving needs of taxpayers. (Taxpayers who want the additional benefits of a sophisticated software program would, of course, remain free to purchase and use one.)

### The Right to Be Heard

Taxpayers have the right to raise their objections and provide additional documentation or an explanation in response to actions by the IRS, which shall consider those objections and explanations promptly and impartially. The right to be heard is articulated in several IRC sections, as well as in the Internal Revenue Manual (IRM).<sup>28</sup> Moreover, the IRS shall provide the taxpayer with an explanation of why those objections or explanations are not sufficient and what is required to better document the taxpayer's concern, where appropriate. Enactment of the following proposed legislative changes will strengthen the right of taxpayers to be heard by the IRS.

- **Math Error Authority.**<sup>29</sup> IRC § 6213(b) authorizes the IRS to assess additional tax without issuing a notice of deficiency where the adjustment is the result of a mathematical or clerical error on the tax return. Using math error authority in these circumstances allows the IRS to assess and collect the additional tax and precludes review in the United States Tax Court, if the taxpayer does not contact the IRS regarding the adjustment within 60 days of the math error notice being sent.<sup>30</sup> A legislative recommendation regarding IRS math error authority was first made in the National Taxpayer Advocate 2002 Annual Report to Congress. In this report, the National Taxpayer Advocate recommended that Congress amend IRC § 6213(g)(2) to confine the definition of mathematical and clerical error to limited and specific situations, such as: inconsistent items in which the inconsistency is determined from the face of the return; omitted items, including schedules, that must be included with the return; and items reported on the return that are numerical or quantitative and can be verified by a government entity that issues or calculates such information. The National Taxpayer Advocate also recommended that Congress repeal IRC § 6213(g)(2)(M), which authorizes the IRS to use math error summary assessment procedures for an entry on the return with respect to a qualifying child for the Earned Income Tax Credit (EITC), where the taxpayer has been identified as the non-custodial parent of that child by the Federal Case Registry of Child Support Orders established under § 453(h) of the Social Security Act. Now, in this report, the National Taxpayer Advocate has recommended that any future expansion of IRS math error authority not be granted until a complete analysis of such expansion has been conducted ensuring that it does not increase taxpayer burden, erode taxpayer rights and protections, or create IRS rework. Specifically,

<sup>28</sup> See, e.g., IRC §§ 7521(b)(1); 6213(a), 7522; IRM 4.10.8.1.1 (Aug. 11, 2006).

<sup>29</sup> See National Taxpayer Advocate 2002 Annual Report to Congress 185-197. For further discussion of Math Error Authority, see Legislative Recommendation: *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error to Protect Taxpayer Rights, infra.*

<sup>30</sup> IRC § 6213(b)(2)(A). When the taxpayer contacts the IRS regarding his or her disagreement of the adjustment in the notice, the IRS will abate the assessment and will continue with assessment through normal deficiency procedures.

the National Taxpayer Advocate recommends that Congress require the Department of Treasury, in conjunction with the National Taxpayer Advocate, to evaluate and report to Congress on whether any proposed expansions satisfy specific criteria.<sup>31</sup>

- **Crediting an Overpayment Against an Unassessed, Outstanding Tax Liability.**<sup>32</sup> In August of 2007, the IRS issued Revenue Ruling 2007-51, permitting the IRS to (1) reduce refunds pursuant to IRC § 6402(a) to satisfy unassessed tax liabilities, or (2) credit a decrease in tax resulting from a carryback adjustment against an unassessed liability.<sup>33</sup> Permitting the IRS to reduce a refund to satisfy an unassessed liability inappropriately allows collection prior to assessment. Although the examples described in the revenue ruling were limited to corporations, the Office of Chief Counsel indicated that the IRS's legal right under section 6402(a) to offset a refund to unassessed liabilities is not limited to corporations.<sup>34</sup> The IRS's programming, however, generally prevents it from using offsets to collect an individual's disputed liabilities before they are assessed. Although the IRS does not currently use offsets in this manner in the individual taxpayer context, practitioners have expressed concern over the IRS's basis for concluding that it can apply IRC § 6402(a) to unassessed liabilities.<sup>35</sup> Revenue Ruling 2007-51 undermines a taxpayer's right under IRC § 6213 to challenge a proposed deficiency *before* assessment and payment of the tax. Absent compelling public policy, taxpayers, particularly low income taxpayers who often rely on refunds for basic living expenses, should be protected from this type of premature collection. If Congress shares the IRS's concern that large refunds or credits are being issued when corporations have significant unassessed liabilities and this risk is so compelling as to warrant overriding a fundamental taxpayer protection, the National Taxpayer Advocate recommends that Congress carve out a specific exception in IRC § 6402 for these circumstances.

### The Right to Pay the Correct Amount of Tax Due

Multiple IRC sections, the IRS Mission Statement, and RRA 98 detail the right of taxpayers to pay the correct amount of tax due.<sup>36</sup> Taxpayers have the right to expect that the IRS will apply the tax law "with integrity and fairness to all."<sup>37</sup> Thus, taxpayers have the right to pay only the tax legally due and to have all tax credits, benefits, refunds, and other provisions properly applied. Codifying the National Taxpayer Advocate's previously recommended

<sup>31</sup> For specifics on criteria that should be considered when evaluating proposals recommending expansion of math error authority, see Legislative Recommendation: *Mandate that the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error to Protect Taxpayer Rights*, *infra*, and for a discussion regarding administrative challenges faced by the IRS when math error authority is expanded beyond its traditional confines, see Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*, *supra*.

<sup>32</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 442-445.

<sup>33</sup> Rev. Rul. 2007-51, 2007-2 C.B. 573.

<sup>34</sup> See *IRS Maintains Legality of Revenue Ruling on Refund Offsets in Letter to Law Professor*, 2008 TNT 5-9 (Jan. 8, 2008).

<sup>35</sup> See Sam Young, *IRS Response Fails to Cool Debate over Offset Ruling*, 2008 TNT 5-2 (Jan. 8, 2008). See also David Marzahl, *Tax Preparation Group Seeks Clarification on Refund Offset Revenue Ruling*, 2007 TNT 230-23 (Nov. 29, 2007).

<sup>36</sup> See, e.g., IRC §§ 6404(a); 7122; 6015; 6402; 7524; RRA 98 § 3506; IRS Mission Statement.

<sup>37</sup> IRS Mission Statement.

changes discussed below would strengthen the right of taxpayers to pay the correct amount of tax due.

- **Clarify that taxpayers are entitled to raise innocent spouse relief as a defense in collection suits.**<sup>38</sup> Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due.<sup>39</sup> Spouses who live in community property states and file separate returns are generally required to report half of the community income on their separate returns. IRC § 6015, sometimes referred to as the “innocent spouse” rules, provides relief, including “traditional,” “allocated,” and “equitable” relief, from joint and several liability. Similarly, IRC § 66 provides relief from the operation of community property rules. The National Taxpayer Advocate recommends that Congress expressly provide that taxpayers may raise relief under those sections as a defense in any proceeding brought under Title 26 or any case arising under Title 11 of the United States Code.
- **Amend IRC § 6050P to remove the 36-month nonpayment period from a list of triggering events requiring a creditor to issue a Form 1099-C.**<sup>40</sup> A creditor that cancels a debt is generally required to report that amount to the IRS on Form 1099-C, *Cancellation of Debt*, and a taxpayer whose debt is canceled must generally include the amount canceled in his or her income when filing a tax return. However, current Treasury regulations create a presumption that a 36-month period in which the debtor does not make a payment is a “triggering event” that requires the creditor to issue a Form 1099-C, even where the creditor is not actually discharging the debt.<sup>41</sup> Thus, the creditor may be collecting the debt even as the IRS asserts the taxpayer owes additional tax based on the reported cancellation. The National Taxpayer Advocate recommends that Congress amend IRC § 6050P to remove the 36-month regulatory “testing period” as a basis on which to issue a Form 1099-C.
- **Amend IRC § 6511 to Allow Refund Claims Past the RSED When Excess Collection Is Due to IRS Error.**<sup>42</sup> The IRS sometimes levies on taxpayer accounts in excess of the tax liability owed. If the taxpayer does not claim a refund within the statutorily-permitted time,<sup>43</sup> the IRS will not honor the claim, even if the mistake is attributable solely to IRS error and the taxpayer did not learn of the error prior to the refund statute expiration date (RSED). The National Taxpayer Advocate recommends that the IRS be required to send out annual statements to taxpayers under continuous levy showing payments received, penalties assessed, and interest charged. Alternatively, the

<sup>38</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 377-382; National Taxpayer Advocate 2009 Annual Report to Congress 378-380; National Taxpayer Advocate 2007 Annual Report to Congress 549-550.

<sup>39</sup> IRC § 6013(d)(3).

<sup>40</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 383-386.

<sup>41</sup> Treas. Reg. § 1.6050P-1.

<sup>42</sup> See National Taxpayer Advocate 2006 Annual Report to Congress 547-548.

<sup>43</sup> IRC § 6511(a) provides the general rule that a claim for refund must be filed within three years from the time the return was filed, or two years from the date the tax was paid, whichever period expires later.

National Taxpayer Advocate recommends that taxpayers be allowed two years from the date they learned of the excess collection to file a refund claim if the excess collection is due to IRS error.

### The Right to an Appeal (Administrative and Judicial)

Administrative and judicial appeals are crucial to the actual and perceived fairness of the tax system from the taxpayer perspective. The rights to these remedies are protected by many IRC sections, Treasury Regulations, and RRA 98.<sup>44</sup> Taxpayers have the right to be advised of and avail themselves of a prompt administrative appeal that provides an impartial review of *all* compliance actions (unless expressly barred by statute) and an explanation of the Appeals Division's decision. Taxpayers have the right to expect that Appeals personnel will generally not engage in *ex parte* communications with IRS compliance personnel except in certain permitted circumstances.<sup>45</sup> In order to further protect the rights of taxpayers to an appeal, Congress should enact the National Taxpayer Advocate's previously recommended legislative changes, discussed below.

- **Strengthen the Independence of the IRS Office of Appeals and Require at Least One Appeals Officer and Settlement Officer in Each State.**<sup>46</sup> RRA 98 provided that the IRS Office of Appeals (Appeals) should be independent from the IRS, should eliminate prohibited *ex parte* communications with the IRS, and should ensure that an appeals officer is regularly available within each state.<sup>47</sup> In recent years, Appeals has eliminated offices in several states and substituted a system of traveling Appeals officers. At the end of FY 2011, nine states and Puerto Rico had no appeals or settlement officers with a post-of-duty within their geographic borders.<sup>48</sup> Additionally at the end of FY 2011, six states had only appeals officers and no settlement officers with a post-of-duty within the state.<sup>49</sup> The National Taxpayer Advocate recommends that Congress require and fund Appeals to have at least one appeals officer and settlement officer located and regularly available within every state, the District of Columbia, and Puerto Rico, and allow taxpayer access to telephonic, correspondence, or face-to-face hearings with a local Appeals office upon request. The National Taxpayer Advocate further recommends that each Appeals office be required to maintain its own space, equipment (*e.g.*, fax machine), and mailing address separate from any co-located IRS office.

<sup>44</sup> See, *e.g.*, IRC §§ 7123; 6330; 6320; 6213; Treas. Reg. §§ 601.106; 601.103(b); RRA 98 § 1001(a)(4).

<sup>45</sup> See RRA 98 § 1001(a)(4); Rev. Proc. 2000-43, 2000-2 C.B. 404. Note that proposed changes to Rev. Proc. 2000-43 were announced in Notice 2011-62, 2011-32 I.R.B. 126.

<sup>46</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 346-350.

<sup>47</sup> See RRA 98 §§ 1001(a)(4); 3465(b).

<sup>48</sup> IRS, Office of Appeals (Appeals), Onrolls Listing for Non-Supervisory Appeals and Settlement Officers (Nov. 19, 2011). Alaska, Arkansas, Idaho, Kansas, Montana, North Dakota, Rhode Island, Vermont, Wyoming, and Puerto Rico had no appeals or settlement officers at the end of FY 2011. Settlement Officers hold Collection Due Process Hearings under IRC §§ 6320 and 6330, and hear appeals of installment agreement denials and offer in compromise rejections under IRC § 7122(e).

<sup>49</sup> IRS, Office of Appeals (Appeals), Onrolls Listing for Non-Supervisory Appeals and Settlement Officers (Nov. 19, 2011). Delaware, Hawaii, Iowa, Maine, South Dakota, and West Virginia had one or more appeals officers, but no settlement officers at the end of FY 2011.

- **Collection Due Process and Uneconomical Levies.**<sup>50</sup> Before levying on property or right to property which is to be sold, the IRS must conduct a thorough investigation of the status of the property, including whether there is equity in such property or the levy is uneconomical.<sup>51</sup> Court decisions have held that an Appeals hearing officer need not verify that the IRS conducted the “equity in property” review required by IRC § 6331(j) prior to proposing a levy action that triggers a CDP hearing.<sup>52</sup> Courts have also held that the Appeals hearing officer need not take into account the uneconomical nature of the levy under the CDP “balancing” of the government’s interests against the intrusiveness of the action from the taxpayer’s perspective.<sup>53</sup> However, the failure to investigate and determine the uneconomical nature of a proposed levy action prior to a CDP hearing on the appropriateness of the levy action renders that hearing meaningless. By not weighing these two factors, the IRS fails to provide the necessary oversight of IRS collection activity that Congress intended. Thus, the National Taxpayer Advocate recommends that Congress amend IRC §§ 6330(c)(1), (c)(2)(A), and (c)(3)(C) to clarify that the Appeals hearing officer must, prior to making a determination under IRC § 6330(c)(3), consider the IRS analysis required under IRC § 6331(j) in balancing the government’s interest in efficient tax collection with the taxpayer’s legitimate concern about the intrusiveness of the proposed levy action.
- **Restructuring and Reform of Collection Due Process Provisions.**<sup>54</sup> CDP hearings afford taxpayers the opportunity to obtain meaningful review of IRS collection actions by an impartial Appeals officer and the courts, either after the initial filing of a Notice of Federal Tax Lien (NFTL) or before an initial levy on a taxpayer’s assets. The current statutory CDP rights are both under-inclusive and over-inclusive, denying judicial review of some lien and levy actions, while encouraging counterproductive behavior on the part of some taxpayers and the IRS. To enhance taxpayer protections in the tax collection process while ensuring that the IRS’s ability to collect the correct amount of tax is not unreasonably impaired, we recommend that Congress (1) require the IRS to issue a separate CDP Right to Hearing notice at the time it undertakes the first levy action with respect to a tax, specifying the levy source and the date the levy will occur and providing the taxpayer with the name and contact information of an IRS employee to contact about the levy action; and (2) codify both the IRS Collection Appeals Program (CAP) and the IRS Audit Reconsideration Process and specifically include Audit Reconsideration as an alternative to be considered at CDP hearings.

<sup>50</sup> See National Taxpayer Advocate 2006 Annual Report to Congress 551-552.

<sup>51</sup> IRC § 6331(j).

<sup>52</sup> The United States Court of Appeals for the Sixth Circuit agreed with the Commissioner’s reasoning that “[a]ll that the statute requires is that the IRS investigate the equity in a property prior to levying on it, not prior to the collection due process hearing.” *Living Care Alternatives of Utica, Inc.*, 411 F.3d 62, 628-29 (6th Cir. 2005). See also *Medlock v. U.S.*, 325 F. Supp. 2d 1064, 1079 (C.D. Cal. 2003) (stating, “According to the plain language of the relevant statutory sections [6331(f) and 6331(j)] these actions must be taken before a taxpayer’s property may be levied upon by the IRS but are prematurely raised at this stage of the collection process.”).

<sup>53</sup> “[T]here is no requirement that the government consider in its balancing analysis whether it will receive any revenue from a levy and sale, or whether the business will have to close down due to the levy and sale.” *Living Care Alternatives of Utica, Inc.*, 41 F.3d at 628 (citations omitted).

<sup>54</sup> See National Taxpayer Advocate 2005 Annual Report to Congress 447-463; National Taxpayer Advocate 2004 Annual Report to Congress 451-470.

### The Right to Certainty

Taxpayers have the right to know the tax implications of their actions and the date and circumstances under which certain actions are final (*e.g.*, the date by which a Tax Court petition must be filed, the applicable periods of limitations, the circumstances under which there will be second examinations, and the effect of closing agreements and settlements). These rights are provided for in multiple IRC sections and would be enhanced through the enactment of the National Taxpayer Advocate's previously recommended legislative changes, discussed below.<sup>55</sup>

- **Provide a Uniform Definition of a Hardship Withdrawal from Qualified Retirement Plans.**<sup>56</sup> The tax code describes over a dozen tax-advantaged plans and arrangements to encourage taxpayers to save for retirement. While these tax-advantaged retirement planning vehicles help taxpayers save, they are subject to differing sets of rules regulating eligibility, contribution limits, taxation of contributions and distributions, withdrawals, availability of loans, and portability. Particularly confusing are the rules governing certain distributions from qualified plans that are made before age 59½. While some plans allow for an early distribution when a hardship event occurs, the various plans do not have uniform "hardship withdrawal" provisions. Even if a plan allows for a hardship withdrawal, participants must deal with inconsistent rules triggering the ten percent additional tax for early withdrawal imposed by IRC § 72(t). The National Taxpayer Advocate recommends that Congress establish uniform rules on the availability and tax consequences of hardship withdrawals from qualified retirement plans, and that such distributions be exempt from the ten percent additional tax.
- **Provide a Fixed Statute of Limitations for U.S. Virgin Islands Taxpayers.**<sup>57</sup> For most U.S. citizens, the filing of a tax return with the IRS starts a three-year statute of limitations (SOL) on assessment within which the IRS must assess any deficiency.<sup>58</sup> *Bona fide* residents of the U.S. Virgin Islands (USVI) are required to pay taxes to and file with the USVI Bureau of Internal Revenue rather than the IRS if they satisfy each of the requirements of IRC § 932(c)(4). Individuals who fail to meet any of those requirements must file a Federal income tax return with the IRS. Over the years, the IRS has reached different conclusions about the extent to which USVI residents have the benefit of a SOL. In 2008, the IRS and the Treasury Department issued final regulations under IRC § 932, providing for a statute of limitations for individuals filing a USVI return and claiming to be *bona fide* residents of the USVI; such a return would be deemed to be a U.S. income tax return and thus the statute of limitations on assessment in IRC § 6501(a) would begin running from the date of filing with the USVI.<sup>59</sup> That statute of limitations, however, was only applicable to tax years ending on or after

<sup>55</sup> See, *e.g.*, IRC §§ 7481; 6501; § 6502; 6511; 6213(a); 7605(b).

<sup>56</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 384-390.

<sup>57</sup> See *id.* at 391-399.

<sup>58</sup> See IRC § 6501(a).

<sup>59</sup> Treas. Reg. § 1.932-1(c)(2)(ii).

December 31, 2006. Consequently, certain taxpayers claiming to be *bona fide* residents of the USVI were not given the benefit of a SOL. The National Taxpayer Advocate recommends clarifying the law so that the filing of a return with the USVI by a person claiming to be a *bona fide* USVI resident starts the SOL to the same extent as filing with the IRS, regardless of the tax years involved.

■ **Eliminate (or Reduce) Procedural Incentives for Lawmakers to Enact Tax Sunsets.**<sup>60</sup>

The IRC contains more than 150 provisions that are temporary and set to expire in tax years 2011-2020, up from about 21 in 1992.<sup>61</sup> Tax benefits have increasingly been enacted for a limited number of years in order to reduce their cost for budget-scoring purposes. Tax sunsets make it difficult for both the government and taxpayers to plan ahead, especially when there is significant uncertainty about whether Congress will extend a provision that is set to expire. The complexity and uncertainty caused by sunsets makes it more difficult for taxpayers to estimate liabilities and pay the correct amount of estimated taxes, complicates tax administration for the IRS, reduces the effectiveness of tax incentives, and may even reduce tax compliance. The National Taxpayer Advocate recommends that Congress consider several options to reduce or eliminate the procedural incentives to enact temporary tax provisions.

### The Right to Privacy

Taxpayers have the right to expect that any IRS inquiry or enforcement action will involve as little intrusion into taxpayers' lives as possible, will be limited to information relevant to the matter at hand, and will follow all due process considerations, including search and seizure protections and the provision of a collection due process hearing, where required. Enacting the National Taxpayer Advocate's previously recommended legislative changes, discussed below, would enhance and further protect a taxpayer's right to privacy.

- **Waiver of Levy Prohibition Under IRC § 6331(k).**<sup>62</sup> IRC § 6331(k) generally provides that the IRS cannot levy on a taxpayer's assets while an offer in compromise (OIC) is pending, or an installment agreement (IA) is pending or in effect. This prohibition does not apply, however, if the taxpayer files a written notice with the IRS waiving the levy restriction.<sup>63</sup> The National Taxpayer Advocate has witnessed occasions when the IRS has attempted to require a waiver in exchange for agreeing to an IA or OIC. To protect taxpayers from IRS overreaching, the National Taxpayer Advocate recommends that Congress amend IRC § 6331(k)(3)(A) to clarify that the IRS is prohibited from conditioning approval of an IA or OIC on the taxpayer's waiving the levy prohibition.

<sup>60</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 397-409. Legislative activity incorporating this recommendation in whole or in part: S. 727, 112th Congress (2011).

<sup>61</sup> Cf. William G. Gale and Peter R. Orszag, Tax Policy Center, *Sunsets in the Tax Code*, 99 Tax Notes 1553 (June 9, 2003) (describing 21 tax provisions set to expire over a five-year period as of January 1992) with Joint Committee on Taxation, JCX- 2-11, *List of Expiring Federal Tax Provisions, 2010-2020* (Jan. 21, 2011) (listing 161 expiring provisions, which are all scheduled to sunset by the end of 2020, with 90 in tax year 2011 alone).

<sup>62</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 446-448.

<sup>63</sup> Treas. Reg. § 301.6331-4(a)(4).

- **Levy Actions on Fixed and Determinable Rights.**<sup>64</sup> The IRS, by virtue of placing a single levy upon a taxpayer's fixed and determinable right to future benefits prior to the Collection Statute Expiration Date (CSED), can levy upon a taxpayer's retirement or disability benefits without any limitation in time. The National Taxpayer Advocate recommends that Congress restrict the IRS's ability to levy indefinitely under IRC § 6331(a) upon a taxpayer's fixed and determinable right to future retirement and disability benefits (including Social Security and private pension and disability plan benefits) to cases where the taxpayer has exhibited flagrant conduct; and exclude post-CSED accruals of penalties and interest from IRS collection when the IRS makes a pre-CSED levy upon a taxpayer's fixed and determinable rights to future payments.

### The Right to Confidentiality

Taxpayers have the right to expect that any information provided to the IRS will not be used or disclosed by the IRS unless authorized by the taxpayer or other provision of law. Taxpayers also have the right to expect that the IRS will conduct appropriate oversight over those who assist in tax administration (tax preparers, tax software providers, electronic return originators) to ensure that returns and return information are protected from unauthorized use or disclosure. Currently the right to confidentiality is protected by at least six IRC sections.<sup>65</sup> However, by enacting the following previously proposed legislative changes, Congress would enhance the taxpayer's right to confidentiality.

- **Consent-Based Disclosures of Tax Return Information Under IRC § 6103(c).**<sup>66</sup> When closing on a mortgage, for example, borrowers often must consent to disclose certain tax information to verify their income. In practice, this consent often involves signing a *blank* copy of Form 4506-T, *Request for Transcript of Tax Return*, which gives the lender access to four years of tax information for 120 days from the date on the form. However, the information is not subject to the same protection and limits on use as other taxpayer information, which raises numerous privacy concerns. The National Taxpayer Advocate recommends that IRC § 6103(c) be amended to limit the redisclosure or use of tax returns and tax return information requested through taxpayer consent solely to the extent necessary to achieve the purpose for which the consent was given by the taxpayer. Congress should further amend IRC § 6103(p)(3)(C) to require the Treasury to include in the Secretary's annual disclosure report to the Joint Committee on Taxation detailed information about the number and types of disclosures made pursuant to taxpayer consent. To deter misuse of taxpayer return information obtained through an IRC § 6103(c) consent, IRC §§ 7213A and 7431 should be amended to apply criminal and civil sanctions.

<sup>64</sup> See National Taxpayer Advocate 2006 Annual Report to Congress 527-530.

<sup>65</sup> See, e.g., IRC §§ 6103; 7216; 6713; 7803(c)(4)(A)(iv); 7602(c); 7525.

<sup>66</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 554-555.

- **Disclosure of Returns and Return Information to Other Agencies — IRC Section 6103.**<sup>67</sup> In situations where another government agency requires a taxpayer’s return or return information, the National Taxpayer Advocate recommends that statutory exceptions for disclosure be limited to those rare instances in which an agency has demonstrated a compelling need for that information and it cannot be reasonably obtained from another source. All such disclosures should be subject to appropriate safeguards and procedures for maintaining the confidentiality of the tax information in the hands of another agency. The Code should specify limits on the amount and use of disclosed information, and make all violations of those limits subject to civil and criminal sanctions. Disclosure provisions should be designed to minimize access to such information by contractors. Where an agency must use contractors, the disclosures should be limited to a “fact of filing” or “match/mismatch” acknowledgement. If such a narrow disclosure provision is unworkable, then the disclosure of tax information should be limited to the number of nontax administration contractors that the IRS can adequately safeguard. Finally, every ten years, the Congress should direct the Secretary of the Treasury to review all disclosure exceptions in IRC § 6103, make recommendations about their continued necessity, including suggesting repeal where technological or private-sector advances have minimized the need for the disclosure, and report such findings and recommendations to the Joint Committee on Taxation.
- **Use and Disclosure of Tax Return Information.**<sup>68</sup> Absent a statutory or regulatory exception, IRC § 7216 provides criminal sanctions for tax return preparers disclosing or using tax return information without the taxpayer’s consent for any purpose other than tax preparation. Section 7216 of the IRC and the related regulations do not prohibit, however, tax return preparers from using or disclosing tax return information for purposes of soliciting business if the taxpayer has given written consent. Taxpayers often receive multiple forms to sign when hiring preparers. There is no real way to determine whether taxpayers gave informed consent, *i.e.*, whether taxpayers completely understand that they are authorizing the preparer to release their data to a third party, or that confidentiality of their tax return information may not be protected from redisclosure by the third party. Accordingly, Congress should amend both IRC §§ 7216 and 6713 (the civil corollary) to include clear language safeguarding the confidential nature of this information.<sup>69</sup>
- **Authorize Treasury to Issue Guidance Specific to IRC § 6713 Regarding the Use and Disclosure of Tax Return Information by Preparers.**<sup>70</sup> IRC § 6713 has historically been identified as the civil counterpart to the criminal penalty imposed on tax return

<sup>67</sup> See National Taxpayer Advocate 2003 Annual Report to Congress 232-255.

<sup>68</sup> See National Taxpayer Advocate 2006 Annual Report to Congress 496-502.

<sup>69</sup> For example, Congress should amend IRC § 7216(b)(3) to specifically require that the regulations thereunder provide the required presentation of written consents and requirements for obtaining the taxpayer’s signature on such consents. The statute should also specifically require that the regulations provide safe harbor language for written consents. Such safe harbor language should include information on consent limitations, duration of consents, and contact information to report violations.

<sup>70</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 547-548.

preparers under IRC § 7216. Like IRC § 7216, it provides a broad prohibition against the use and disclosure of tax return information. Because of IRC § 6713(b)'s cross-reference to IRC § 7216(b), the current statutory framework seemingly requires exceptions for both the criminal and civil statutes or for neither. The Treasury Department is understandably reluctant to subject preparers to criminal sanctions except for egregious conduct, so it has used its regulatory authority to carve out broad exceptions from the general prohibition on the use or disclosure of tax return information set forth in IRC § 7216. The National Taxpayer Advocate believes taxpayer protections would be stronger if Treasury is given the flexibility to issue regulations applicable only to the civil penalty without concern that the criminal penalty would also apply.

- **Refine whistleblower procedures to better protect taxpayer privacy while providing necessary information to whistleblowers.**<sup>71</sup> Generally, tax return information is confidential. The circumstances under which the IRS may disclose a taxpayer's return information to a whistleblower is limited.<sup>72</sup> However, if a whistleblower appeals to the United States Tax Court the IRS's determination regarding an award, the taxpayer's return information may become public. Thus, whistleblower claims may allow public disclosure of this information without the taxpayer's knowledge or consent in proceedings to which the whistleblower — but not the taxpayer — is a party. The National Taxpayer Advocate recommends that Congress amend IRC § 7623 and other applicable provisions to require redaction of third-party return information in administrative and judicial proceedings on a whistleblower claim, with an opportunity for the taxpayer to request further redactions before disclosure.<sup>73</sup> The taxpayer would retain a subsequent right of action for civil damages for unauthorized disclosure by the whistleblower.

### The Right to Representation

Taxpayers have the right to be represented in contacts, transactions, and controversies with the IRS by an authorized representative of their choice. Moreover, taxpayers who do not have the means to afford representation may be eligible for representation by Low Income Taxpayer Clinics (LITCs) and Student Tax Clinics that provide such representation for free or for a nominal fee. The right to have representation when interacting with the IRS is acknowledged in at least three IRC sections.<sup>74</sup> By codifying the following previously proposed legislative changes, Congress would further protect and enhance a taxpayer's right to representation.

<sup>71</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 396-399.

<sup>72</sup> A "whistleblower" is an individual who provides information to the IRS regarding violations of tax laws and submits a claim under IRC § 7623 for a reward. Treas. Reg. § 301.6103(n)-2.

<sup>73</sup> The Tax Court recently announced proposed amendments to its rules of practice and procedure. Under new proposed rule 345, a whistleblower can proceed anonymously in the Tax Court, and name, address, and other identifying information of the taxpayer to which the whistleblower claim relates must be redacted. The Tax Court's explanation for new proposed rule 345 cites the National Taxpayer Advocate's letter to the Tax Court, dated March 1, 2011, supporting such proposed amendment.

<sup>74</sup> See, e.g., IRC §§ 7521; 7526; 7430.

- **Amend IRC § 7430 to clarify that attorney fee awards may not be retained by the government to satisfy a litigant’s preexisting government debts.**<sup>75</sup> IRC § 7430 provides that courts may award attorneys’ fees to taxpayers who prevail against the United States in connection with the determination, collection, or refund of any tax if certain procedural requirements are met. Fee-shifting provisions like § 7430 are intended to decrease apprehension among those who feel they have been victims of unreasonable government action but who might be reluctant to challenge those actions because of the expense involved in securing representation. In 2010, the United States Supreme Court held that the attorneys’ fees awarded under the Equal Access to Justice Act<sup>76</sup> were payable to the litigant and thus subject to offset by the government to satisfy a litigant’s preexisting but unrelated government debt.<sup>77</sup> Subjecting attorney fee awards to offset for unrelated government debts of the litigant undercuts the purpose of fee-shifting statutes and creates a chilling effect on reduced fee and *pro bono* assistance. The National Taxpayer Advocate recommends that Congress amend IRC § 7430 to clarify that attorneys’ fees cannot be used to satisfy a litigant’s preexisting government debt.
- **Referral to Low Income Taxpayer Clinics.**<sup>78</sup> The National Taxpayer Advocate has discussed at length the impact that representation has on the outcome of a taxpayer’s case, particularly in EITC examinations.<sup>79</sup> One opportunity for some taxpayers to obtain representation before the IRS is through LITCs.<sup>80</sup> However, the Supplemental Standards of Ethical Conduct for Employees of the Department of the Treasury<sup>81</sup> prohibit the recommendation or referral of specific attorneys or accountants. Although IRS employees do refer taxpayers to the existence of LITCs through Publication 4134, the Office of Government Ethics’ Standards of Ethical Conduct for Employees of the Executive Branch<sup>82</sup> further limit IRS employees’ ability to refer taxpayers to specific LITCs for representation. The National Taxpayer Advocate recommends amending IRC § 7526(c) to add a special rule clarifying that notwithstanding any other provision of law, IRS employees may refer taxpayers to specific LITCs receiving funding under this section.

<sup>75</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 406-409.

<sup>76</sup> 28 U.S.C. § 2412.

<sup>77</sup> *Astrue v. Ratliff*, 130 S. Ct. 2521 (2010). See also 28 U.S.C. § 2412(d).

<sup>78</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 551-553. Legislative activity incorporating this recommendation in whole or in part: S. 1573, 112th Congress (2011), H.R. 5047, 111th Cong. (2010), S. 3215, 111th Cong. (2010), H.R. 4994, 111th Cong. (2010), H.R. 5719, 110th Cong. (2008).

<sup>79</sup> See *id.* at vol. 2, 94-117 (Research Report: *IRS Earned Income Credit Audits — A Challenge to Taxpayers*). In tax year 2004 nearly twice as many audited EITC taxpayers with representation were found eligible for the EITC. Similarly, taxpayers with representation retained, on average, 45 percent of the EITC compared to 25 percent for taxpayers without representation — nearly twice as much.

<sup>80</sup> See IRC § 7526. Low income taxpayer clinics provide professional representation before the IRS or in court on audits, appeals, tax collection disputes, and other issues for free or for a small fee. Some clinics can provide information about taxpayer rights and responsibilities in many different languages for individuals who speak English as a second language.

<sup>81</sup> 5 C.F.R. Part 3101.

<sup>82</sup> 5 C.F.R. Part 2635.

### The Right to a Fair and Just Tax System

Many IRC sections protect the right of taxpayers to a fair and just tax system.<sup>83</sup> Taxpayers have the right to expect that the tax system will take into consideration the specific facts and circumstances that might affect taxpayers' underlying liability, ability to pay, or ability to provide information timely (*e.g.*, by abatement of tax, penalty or interest; offers in compromise, or installment agreements; or extensions of time to file or submit information, unless statutorily prohibited). Taxpayers have the right to access to the Office of the Taxpayer Advocate for assistance. Taxpayers have the right to compensation or damages where the IRS has excessively erred, delayed, or taken unreasonable positions.<sup>84</sup> Enacting the legislative changes discussed below would enhance the right of taxpayers to a fair and just tax system.

- **Enact Tax Reform Now.**<sup>85</sup> The National Taxpayer Advocate recommends that Congress make fundamental tax reform a high priority and approach reform in a manner similar to zero-based budgeting. The starting assumption should be that all tax expenditures would be eliminated unless a compelling business case can be made that the benefits of providing a tax incentive through the Code outweigh the tax-complexity challenges that special rules create. Factors to consider in making this assessment include whether the government continues to place a priority on encouraging the activity for which the tax incentive is provided, whether the incentive is accomplishing its intended purpose, and whether a tax expenditure is more effective than a direct expenditure.
- **Strengthen Taxpayer Protections in the Filing and Reporting of Federal Tax Liens.**<sup>86</sup> The tax code authorizes the IRS to file a Notice of Federal Tax Lien in the public record when a taxpayer owes past-due taxes. The purpose is to protect the government's interests in the taxpayer's property. However, the filing of a tax lien can significantly harm the taxpayer's credit and affect his or her ability to obtain financing, find or retain a job, secure affordable housing or insurance, and ultimately pay the outstanding tax debt. For these reasons, the National Taxpayer Advocate believes the IRS should not automatically file NFTLs but instead should carefully consider and balance these competing interests when determining whether a lien filing is appropriate. Moreover, the current inconsistent NFTL reporting of different federal tax lien events by credit reporting agencies may create unnecessary financial distress for taxpayers without furthering the government's overriding and compelling interest in ensuring the taxpayers' future compliance. The National Taxpayer Advocate recommends that Congress amend the tax code to provide clear and specific guidance about the factors the IRS

<sup>83</sup> See, *e.g.*, IRC §§ 6404(a); 6404(e); 7122; 6159; 7811; 6511(h).

<sup>84</sup> See, *e.g.*, IRC §§ 6673(a)(2); 7430.

<sup>85</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 365-372 and National Taxpayer Advocate 2005 Annual Report to Congress 375-380. Legislative activity incorporating this recommendation in whole or in part: S. 727, 112th Congress (2011).

<sup>86</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 357-364. Legislative activity incorporating this recommendation in whole or in part: H.R. 6439, 111th Congress (2010), H.R. 5047, 111th Congress (2010), S. 3215, 111th Congress (2010).

must consider in making NFTL filing determinations. The National Taxpayer Advocate also recommends requiring pre-filing administrative review of IRS lien determinations by the IRS Office of Appeals, permitting taxpayers to bring civil actions for damages in connection with improper NFTL filings or the IRS's failure to make the required NFTL determinations, and amending the Fair Credit Reporting Act<sup>87</sup> to set specific time-frames for reporting derogatory lien information on credit reports.

- **Revise the willfulness component of the trust fund recovery penalty.**<sup>88</sup> Employers are generally required to withhold employment taxes and certain types of excise taxes, often called “trust fund” taxes, from payments to employees. IRC § 6672 provides for the assessment of a Trust Fund Recovery Penalty (TFRP) against defined “responsible persons” when these monies are not paid as required. To establish liability for this penalty, the IRS must conclude that the failure to pay the trust fund taxes was willful. Willfulness is established if the person had knowledge of the employer’s obligation to pay the taxes and knew the funds were being used for other purposes. The statute does not contain a “reasonable cause” exception, nor does it treat the delinquency differently if it was caused by a third-party bad act such as mismanagement or embezzlement by an employee or third-party payor. The National Taxpayer Advocate recommends that Congress amend IRC § 6672 to provide that the conduct of a responsible person who obtains knowledge of trust fund taxes not being timely paid because of an intervening bad act shall not be deemed willful if the delinquent business: (1) promptly makes payment arrangements to satisfy the liability based upon the IRS’s determination of the minimal working capital needs of the business, and (2) remains current with payment and filing obligations.
- **Eliminate the Suspension of the Collection Statute During Qualified Hospitalization Resulting from Service in a Combat Zone.**<sup>89</sup> IRC § 7508(a) generally provides for the suspension of collection activities and of the Collection Statute Expiration Date (CSED) under IRC § 6502 while a taxpayer is continuously hospitalized from an injury sustained during service in a combat zone. The IRS has administrative discretion to suspend collection activity against civilians during periods of hospitalization but is not required to suspend the CSED for these taxpayers. As a result, U.S. military personnel may be placed at a disadvantage compared to civilians, because civilians may receive the benefit of deferred collection action without having to agree to extend the CSED beyond ten years, while the CSED is statutorily extended beyond ten years for military personnel. To protect individuals serving in combat from an unnecessary suspension of the CSED and to treat these individuals consistently with civilian taxpayers, the National Taxpayer Advocate recommends amending IRC § 7508(a) to eliminate the suspension of the CSED.

<sup>87</sup> 15 U.S.C. §§ 1681-1681x.

<sup>88</sup> See National Taxpayer Advocate 2010 Annual Report to Congress 400-405.

<sup>89</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 381-383.

- **Repeal the Alternative Minimum Tax for individuals.**<sup>90</sup> Few people think of having children or living in a high-tax state as tax-avoidance maneuvers, but under the unique logic of the Alternative Minimum Tax (AMT)<sup>91</sup>, that is how those actions are treated. The AMT effectively requires taxpayers to compute their taxes twice — once under the regular rules and again under the AMT rules — and then pay the higher of the two amounts. The regular tax rules allow taxpayers to claim tax deductions for each dependent (recognizing the costs of maintaining a household and raising a family) and for taxes paid to state and local governments (reducing “double taxation” at the federal and state levels), but the AMT rules disallow those deductions. An estimated 77 percent of all additional income subject to tax under the AMT is attributable to the disallowance of deductions for dependents and state and local tax payments.<sup>92</sup> The AMT computations are also extremely burdensome. The National Taxpayer Advocate recommends that Congress repeal the AMT for individuals.
- **Measures to Address Noncompliance in the Cash Economy.**<sup>93</sup> Income from the “cash economy” — income from legal activities that is not reported to the IRS by third parties — is the type of income most likely to go unreported. Unreported income from the cash economy is probably the single largest component of the tax gap, likely accounting for over \$100 billion per year. Because significant noncompliance by some taxpayers is not fair to those who timely pay their taxes, Congress and the IRS must do more to address this problem. We can improve voluntary compliance by making it easier for taxpayers to understand and meet their tax obligations, and by enhancing the tools available to the IRS for enforcing the tax laws when necessary, in ways that are minimally intrusive, impose the least possible burden, and protect taxpayer rights.
- **De Minimis Apology Payments.**<sup>94</sup> The authority to make *de minimis* apology payments to taxpayers is a mechanism that would help restore taxpayer faith in the tax system when a taxpayer has been seriously mistreated by the IRS. This authority, vested solely in the National Taxpayer Advocate, would be nondelegable. The National Taxpayer Advocate, at her discretion, would be authorized to make a *de minimis* payment to a taxpayer where the taxpayer has incurred excessive expense or experienced

<sup>90</sup> See National Taxpayer Advocate 2008 Annual Report to Congress 356-362; National Taxpayer Advocate 2004 Annual Report to Congress 383-385; National Taxpayer Advocate 2001 Annual Report to Congress 166-177. Legislative activity incorporating this recommendation in whole or in part: S. 727, 112th Congress (2011), S. 3018, 111th Cong. (2010), S. 932, 111th Cong. (2009), H.R. 782, 111th Cong. (2009), H.R. 240, 111th Cong. (2009), S. 2293, 110th Cong. (2007), H.R. 3970, 110th Cong. (2007), H.R. 1942, 110th Cong. (2007), S. 14, 110th Cong. (2007), S. 1040, 110th Cong. (2007), H.R. 1365, 110th Cong. (2007), S. 55, 110th Cong. (2007), H.R. 3841, 109th Cong. (2005), H.R. 2950, 109th Cong. (2005), S. 1103, 109th Cong. (2005), H.R. 1186, 109th Cong. (2005), H.R. 4164, 108th Cong. (2004), H.R. 4131, 108th Cong. (2004), H.R. 3060, 108th Cong. (2003), S. 1040, 108th Cong. (2003), H.R. 1233, 108th Cong. (2003), H.R. 43, 108th Cong. (2003), H.R. 5166, 107th Cong. (2002), S. 616, 107th Cong. (2002), H.R. 437, 107th Cong. (2001).

<sup>91</sup> IRC § 55.

<sup>92</sup> See Tax Policy Center, Tax Facts: AMT Preference Items 2002, 2004-2006 (citing unpublished tabulations from the Office of Tax Analysis, Department of the Treasury), available at [http://www.taxpolicycenter.org/taxfacts/Content/PDF/amt\\_preference.pdf](http://www.taxpolicycenter.org/taxfacts/Content/PDF/amt_preference.pdf).

<sup>93</sup> See National Taxpayer Advocate 2007 Annual Report to Congress 490-502. Legislative activity incorporating this recommendation in whole or in part: Pub. L. No. 111-148 § 9006, 124 Stat. 119, 855 (Mar. 23, 2010).

<sup>94</sup> *Id.* at 478-498. Legislative activity incorporating this recommendation in whole or in part: S. 1289, 112th Congress (2011), S. 3795, 111th Congress (2010).

undue burden as a result of an IRS mistake, action, or failure to act. The National Taxpayer Advocate's decision with respect to an award under this authority would not be appealable or reviewable. To be eligible for such a payment, the taxpayer would have to meet established criteria. The National Taxpayer Advocate recommends that Congress amend IRC § 7811 to grant the National Taxpayer Advocate the discretionary, nondelegable authority to compensate taxpayers where the action or inaction of the IRS has caused excessive expense or undue burden to the taxpayer, and the taxpayer meets the IRC § 7811 definition of significant hardship.

- **Effective Tax Administration Offers in Compromise.**<sup>95</sup> In 1998, Congress authorized the IRS to develop guidelines for determining whether an offer in compromise is adequate and should be accepted to resolve a dispute.<sup>96</sup> The legislative history indicates that Congress intended that the IRS compromise tax debts based upon factors such as equity, public policy and hardship in cases where doing so would promote the effective administration of the tax laws (ETA offers).<sup>97</sup> However, the IRS has interpreted the congressional authorization narrowly so that, for example, the IRS group charged with evaluating such offers accepted only 27 ETA offers based upon equity or public policy in FY 2011.<sup>98</sup> Over the years the IRS has clarified and expanded the guidance concerning ETA offers.<sup>99</sup> Nonetheless, the IRS's continuing reluctance to compromise for a reasonable amount in inequitable situations may lead taxpayers to disregard the law or erode their faith in the fairness of the tax system. We recommend that Congress provide more specific guidance to the IRS to ensure that offers submitted under a new "Equitable Considerations" standard are accepted in a broader array of cases.

<sup>95</sup> See National Taxpayer Advocate 2004 Annual Report to Congress 432-450.

<sup>96</sup> RRA 98 § 3462(a).

<sup>97</sup> H.R. Rep. No. 105-599, at 289 (1998).

<sup>98</sup> Email from Small Business/Self-Employed Division OIC Program Manager, on file with TAS.

<sup>99</sup> See Treas. Reg. §§ 301.7122-1(b)(3) and -1(c)(3) (promulgated on July 18, 2002). See also IRM 5.8.11, *Effective Tax Administration* (Sept. 23, 2008).

## Appendix 1: TAXPAYER BILL OF RIGHTS

### National Taxpayer Advocate Partial Analysis of Subordinate Rights and Obligations

#### TAXPAYER RIGHTS

##### 1. The Right to be Informed

- a. IRC § 7521(b)(1): Publication 1: Explanation of rights as taxpayer.
- b. RRA 98, Publication 5: Explanation of Appeals process, and Publication 594: Explanation of the IRS Collection process.
- c. IRC § 7522: Content of tax due, deficiency, and other notices.
- d. IRC § 6751: Notice of penalty must include explanation of the computation.
- e. FOIA and e-FOIA, and requirement of disclosure of instructions to staff (Internal Revenue Manual).
- f. All Code sections that require Secretary to issue guidance.
- g. IRC § 6110: Public inspection of written determinations, including Chief Counsel advice.
- h. RRA 98 § 3501: Explanation of joint and several liability.
- i. RRA 98 § 3506 and Prop. Treas. Reg. § 301.6159-1(h): Annual statement of installment agreement balance and payments made during the year.
- j. IRC § 6402(k): Statement of reason for refund disallowance.

##### 2. The Right to be Assisted

- a. RRA 98 § 1002: The IRS shall review and restate its mission to place a greater emphasis on serving the public and meeting taxpayers' needs.
- b. IRS Mission Statement: Provide America's taxpayers top quality service by helping them to understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.
- c. RRA 98 § 3705: IRS correspondence must include name, phone number, and unique identifying number of an IRS employee that the taxpayer may contact with respect to that correspondence.
- d. RRA 98 § 3709: Listing of IRS local telephone numbers and addresses in telephone book for area.

### 3. The Right to be Heard

- a. IRC § 7521(b)(1): Rights under audit process.
- b. IRM 4.10.8.1.1: Audit reports should contain all information necessary to ensure clear understanding of the adjustments and document how tax liability was computed.
- c. IRC § 6402(k): Statement of reason for refund disallowance. See S. Rep. No. 105-174, at 97: “The Committee believes 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.”
- d. IRC § 6213(b): Math and clerical error summary assessment authority: taxpayer has 60 days after notice to challenge the assessment and request that deficiency procedures apply.
- e. IRC § 7522: Content of tax due, deficiency, and other notices.

### 4. The Right to Pay the Correct Amount of Tax Due

- a. IRS Mission Statement: Provide America’s taxpayers top quality service by helping them to understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.
- b. “Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury.” *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934) (citations omitted), *aff’d*, 293 U.S. 465 (1935).
- c. IRC § 6404(a): The Secretary may abate tax where excessive in amount, barred by statutes of limitations, or erroneously or illegally assessed.
- d. IRC § 7122: Offer in compromise based on doubt as to liability.
- e. IRC § 6015: Relief from joint and several liability.
- f. IRC § 6402: Administrative claim for refund (amended return or other claim).
- g. IRC § 7524: Annual notice of tax delinquency.
- h. RRA 98 § 3506 and Prop. Treas. Reg. § 301.6159-1(h): Annual statement of installment agreement balance and payments made during the year.

### 5. The Right to an Appeal (administrative and judicial)

- a. IRC § 7123: Appeals dispute resolution procedures, including early referral, mediation, and arbitration.
- b. RRA 98 § 1001(a)(4): The Commissioner shall establish an independent and impartial Appeals function, including ex parte rules.
- c. Rev. Proc. 2000-43: Ex parte rules.

- d. Treas. Reg. § 601.106: Appeals functions.
- e. Treas. Reg. § 601.103(b): Where taxpayer does not agree to Exam's proposed assessment, taxpayer is afforded appeal rights.
- f. Treas. Reg. § 601.103(c)(1): Taxpayer is given the opportunity to request an Appeals conference.
- g. IRC §§ 6330 & 6320: Collection due process hearings before an independent and impartial Appeals officer.
- h. IRC § 7122(e): Independent administrative review before rejection of offer in compromise or an installment agreement, and appeal from rejection of offer in compromise or installment agreement.
- i. IRC § 6159(e): Independent administrative review of terminations of installment agreements.
- j. IRC § 6212: Statutory notice of deficiency.
- k. IRC § 6213: Petition to U.S. Tax Court.
- l. IRC § 7428: Declaratory judgment for IRC § 501(c)(3) organizations.
- m. IRC § 7422: Refund suit.

## 6. The Right to Certainty

- a. IRC § 7481: Finality of U.S. Tax Court decision.
- b. IRC § 6501: Limitations on assessment and collection (statute of limitations).
- c. IRC § 6502: Limitations on collection after assessment.
- d. IRC § 6511: Limitations on claim for credit or refund (statute of limitations).
- e. IRC § 6213: Statutory notice of deficiency (assessment after expiration of 90 days and no petition to U.S. Tax Court filed).
- f. IRC § 6213(a): IRS must put actual date of deadline to file petition to U.S. Tax Court in statutory notice of deficiency.
- g. IRC § 7605(b): Restrictions on examination of taxpayer: no unnecessary exams or meetings and only one inspection for taxable year unless taxpayer requests it or after IRS investigates and notifies taxpayer in writing that the second exam is necessary.

## 7. The Right to Privacy (to be free from unreasonable searches and seizures)

- a. IRC § 6331: Levy and distraint rules.
- b. IRC § 6331(j): Procedures for administrative seizures of property.
- c. RRA 98 § 3421: Managerial approval of continuous levies.
- d. IRC § 6340: Accounting of proceeds of sale of property.

- e. IRC § 6334: Property exempt from levy.
- f. IRC § 6335: Sale of seized property.
- g. IRC §§ 6330 & 6320: Collection due process hearings (hearing before first levy with respect to tax; hearing after filing of notice of federal tax lien).

## 8. The Right to Confidentiality

- a. IRC § 6103: Confidentiality of taxpayer returns and tax return information.
- b. IRC §§ 7216 & 6713: Criminal and civil penalties for disclosure or use of tax return information by return preparer.
- c. IRC § 7803(c)(4)(A)(iv): Discretion of local taxpayer advocate not to disclose to the IRS the fact that taxpayer has contacted the Taxpayer Advocate Service (TAS) or any information provided by the taxpayer to TAS.
- d. IRC § 7602(c): Third party contacts: IRS must inform the taxpayer of intent to make third party contacts and provide list of contacts upon request.
- e. IRC § 7525: Confidentiality privilege for federally authorized tax practitioners (extending confidentiality to non-attorney Circular 230 practitioners in disputes before the IRS) to the extent common law attorney-client privilege applies.

## 7. The Right to Representation

- a. IRC § 7521(c): Any attorney, certified public accountant, enrolled agent, enrolled actuary, or any other person permitted to represent the taxpayer before the IRS who is not disbarred or suspended from practice before the IRS may submit a written power of attorney to represent the taxpayer before the IRS.
- b. IRC § 7521: An IRS officer or employee cannot require the taxpayer to attend an interview where represented by a power of attorney, unless pursuant to a summons.
- c. IRC § 7526: Low Income Taxpayer Clinics.
- d. IRC § 7430: Awarding of attorneys fees and administrative/litigation costs.

## 8. The Right to a Fair and Just Tax System

- a. IRC § 6404(a): The Secretary may abate tax where excessive in amount, barred by statutes of limitations or erroneously or illegally assessed.
- b. IRC § 6404(e): Abatement of interest attributable to unreasonable errors or delays by the IRS.
- c. Abatement of penalty for reasonable cause — *e.g.*, IRC § 6651 (failure to pay/failure to file penalties); IRC § 6656 (failure to deposit penalty); and IRC § 6694 (return preparer penalties).

- d. IRC § 7122: Offers in compromise based on doubt as to collectibility, doubt as to liability, economic hardship, equity, and public policy.
- e. IRC § 6159: Installment agreements, including guaranteed installment agreements.
- f. IRC §§ 7803 & 7811: Office of the Taxpayer Advocate, National Taxpayer Advocate, and Taxpayer Assistance Orders.
- g. IRC § 6511(h): Tolling of the statute of limitations for refund claims during periods of taxpayer's incapacity.

## TAXPAYER OBLIGATIONS

### 1. The Obligation to be Honest

- a. IRC § 6065: Verification of returns: Any return, statement, declaration, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by written declaration made under penalties of perjury.
- b. IRC § 6663: Fraud penalty.
- c. IRC § 7206: Fraud and false statements (criminal penalty — felony: fine or imprisonment or both).
- d. IRC § 7207: Fraudulent returns, statements, or other documents (criminal penalty — fine or imprisonment or both).
- e. IRC § 7203: Willful failure to file return, supply information, or pay tax (criminal penalty — misdemeanor or felony: fine or imprisonment or both).

### 2. The Obligation to be Cooperative

- a. IRC § 7203: Willful failure to file return, supply information, or pay tax (criminal penalty — misdemeanor or felony: fine or imprisonment or both).
- b. IRC § 7491(a)(2)(B): Burden of proof: If a taxpayer is cooperative during a court proceeding (*i.e.*, maintained all records required under the Internal Revenue Code and cooperated with reasonable requests for witnesses, information, etc.), the burden of proof shifts to the IRS with respect to any factual issue relevant to the proceeding.

### 3. The Obligation to Provide Accurate Information and Documents on Time

- a. IRC § 6071: Time for filing returns and other documents.
- b. IRC § 6651(a)(1): Penalty for failure to file tax return.
- c. IRC § 7203: Willful failure to file return, supply information, or pay tax (criminal penalty — misdemeanor or felony: fine or imprisonment or both).

- d. IRC § 7602: Examination of books and witnesses (criminal penalty — misdemeanor or felony: fine or imprisonment or both): authority to issue summons for books, papers, records or other data, and authority to issue summons for a person to appear before the IRS.

#### **4. The Obligation to Keep Records**

- a. IRC § 6001: Notice or regulations requiring records, statements, and specific returns: “Every person liable for any tax imposed by this title, or for the collection thereof, shall keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.”
- b. IRC § 274(d): Special substantiation required for entertainment, travel, meals and lodging, and listed property expenses.

#### **5. The Obligation to Pay Taxes on Time**

- a. IRC § 6651(a)(2): Penalty for failure to pay tax.
- b. IRC § 6656: Penalty for failure to make deposits of tax.
- c. IRC § 6654: Penalty for failure by individual to pay estimated income tax.
- d. IRC § 6672: Penalty for failure to collect and pay over tax, or attempt to evade or defeat tax (known as the trust fund recovery penalty (TFRP)).

LR  
#2**Restrict Access to the Death Master File****PROBLEM**

Tax-related identity theft is a growing problem — for its victims, for the IRS, and when Treasury funds are improperly paid to the perpetrators, for all taxpayers. In fiscal year (FY) 2011, the IRS’s centralized Identity Protection Specialized Unit (IPSU) received more than 226,000 cases, a 20 percent increase over FY 2010.<sup>1</sup> In addition, the Taxpayer Advocate Service received over 34,000 identity theft cases in that time, a 97-percent increase over FY 2010.<sup>2</sup>

In a relatively new tactic, some identity thieves are filing tax returns that claim the dependency exemption and various tax credits for deceased individuals. The IRS began to filter out these decedent schemes in April 2011 and has since stopped payment for more than 200,000 questionable returns claiming refunds estimated at more than \$850 million.<sup>3</sup>

Identity thieves have found that Social Security numbers (SSNs) and other personal information of the deceased is easily accessible. One might be surprised to learn that the federal government itself is one source of this information. The Social Security Administration (SSA) maintains a “Death Master File” (DMF) containing the full name, SSN, date of birth, date of death, and the county, state, and ZIP code of the last address on record of decedents.<sup>4</sup> DMF data is updated weekly and made available to the public. Today, anyone can quickly find a number of websites (including genealogy sites) that publish DMF information free or for a nominal fee.<sup>5</sup>

**EXAMPLE**

Aaron and Belinda lose their newborn baby Chloe to Sudden Infant Death Syndrome in August 2010. Distraught and devastated, the couple dutifully reports the death of their child to the SSA, which enters her full name, complete SSN, date of birth, date of death, and address into the DMF.

Zoe is part of an organized crime network. She has heard that filing falsified tax returns is a lucrative endeavor and even paid \$200 to attend a seminar by one of her associates on how to obtain personally identifiable information. As instructed, Zoe visits a for-profit

<sup>1</sup> IRS, *IPSU Identity Theft Report* (Oct. 1, 2011); IRS, *IPSU Identity Theft Report* (Oct. 2, 2010); IRS, *IPSU Identity Theft Report* (Oct. 3, 2009).

<sup>2</sup> In FY 2010, TAS opened 17,291 stolen identity (primary issue code 425) cases. In FY 2011, the number jumped to 34,006. Taxpayer Advocate Management Information System (TAMIS) (Oct. 31, 2011).

<sup>3</sup> TAS notes from IRS Decedent Schemes conference call (June 16, 2011).

<sup>4</sup> See Office of the Inspector General, SSA, *Personally Identifiable Information Made Available to the General Public Via the Death Master File*, A-06-08-18042 (June 2008).

<sup>5</sup> See Boston Herald, *Sandwich Parents Are Twice Robbed* (Nov. 27, 2011); Scripps Howard News Service, *ID Thieves Cashing in on Dead Children’s Information* (Nov. 3, 2011).

genealogy website that purchases DMF data and makes it available in unredacted form at no cost. By the end of the day, Zoe obtains the names, SSNs, and addresses of dozens of deceased individuals. She uses children's names to maximize the available credits, and one of the names she selects is Chloe's. In January 2011, Zoe files a tax return claiming Chloe as a qualifying child for the child tax credit, dependency exemption, and earned income tax credit.

In April 2011, Aaron and Belinda are still too distraught at the thought of Chloe's death to file their tax return and seek an extension. By August, they are ready to move on with their lives, and they file the return. In October 2011, Aaron and Belinda receive a notice from the IRS informing them that someone else claimed Chloe as a dependent for the 2010 tax year. Aaron and Belinda spend the rest of 2011 corresponding with the IRS to prove Chloe was their daughter. During the course of their research, Aaron and Belinda are shocked to discover how easy it is for anyone to access Chloe's personal information, including her full SSN, date of birth, and address.

## RECOMMENDATION

The National Taxpayer Advocate recommends that Congress enact legislation to restrict access to certain personally identifiable information in the DMF. The National Taxpayer Advocate is not recommending a specific approach at this time, but outlines below several available options.

## PRESENT LAW

The Freedom of Information Act (FOIA) provides that any person has a right, enforceable in court, to obtain access to federal agency records.<sup>6</sup> In crafting FOIA, Congress recognized the importance of allowing citizen access to government information. However, Congress also understood the government's need to keep some information confidential, including private information about individuals who might be mentioned in federal files, and thus included nine exemptions in the law.<sup>7</sup>

Personal privacy interests are protected by two exemptions within FOIA. Section 552(b)(6) protects information about individuals in "personnel and medical files and similar files" when the disclosure of such information "would constitute a clearly unwarranted invasion of personal privacy." Section 552(b)(7)(C) relates to information compiled for law enforcement purposes and protects personal information when disclosure "could reasonably be expected to constitute an unwarranted invasion of personal privacy."

The challenge for the courts has been balancing the public's interest in release of the records in question against the privacy interest of the individuals involved. In 1980, the

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<sup>6</sup> See 5 USC § 552.

<sup>7</sup> See 5 USC § 552(b).

United States District Court for the District of Columbia entered a consent judgment in a FOIA lawsuit that required the SSA to disclose the SSN, surname, and date of death (if available) of deceased Social Security beneficiaries once a year upon the request of the plaintiff in the case.<sup>8</sup> Subsequently, the SSA decided to create the DMF, which contains the full name, SSN, date of birth, date of death, and the county, state, and ZIP code of the last address on record, and to provide it on a weekly basis.<sup>9</sup>

In 1989, the Supreme Court clarified that the purpose of FOIA is to enable citizens to find out “what their government is up to” and that this purpose “is not fostered by disclosure of information about private citizens that is accumulated in various government files but that reveals little or nothing about an agency’s own conduct.”<sup>10</sup> The DMF contains personal records of millions of deceased individuals but such records do not reveal much, if anything, about the SSA’s own conduct.<sup>11</sup>

An additional challenge for the courts has been assessing the privacy interest of the deceased. While the death of the subject of personal information diminishes to some extent the privacy interest in that information, courts have held that it does not extinguish that interest.<sup>12</sup> In *Accuracy in Media, Inc. v. Nat’l Park Service*, the U.S. Court of Appeals for the District of Columbia “squarely rejected the proposition that FOIA’s protection of personal privacy ends upon the death of the individual depicted.”<sup>13</sup>

In 2004, the Supreme Court fully recognized that surviving family members also enjoy a privacy interest that must be considered when analyzing the release of agency records as it relates to Exemption 7(C).<sup>14</sup> The U.S. Court of Appeals for the District of Columbia has recognized that the privacy interests of relatives apply to Exemption 6 of FOIA.<sup>15</sup>

Given that (1) the type of information the DMF holds does not reveal much about “what the government is up to,” (2) there is a real threat that identity thieves can easily misuse the information contained in the DMF to claim improper tax benefits, and (3) the victims’ families may suffer emotional and financial harm as they deal with the aftermath of identity theft, we think a court, after conducting the requisite balancing test, might allow the SSA to shield DMF information from disclosure.

<sup>8</sup> See *Perholtz v. Ross*, Civil Action No. 78-2385 and 78-2386, U.S. District Court for the District of Columbia (Apr. 11, 1980).

<sup>9</sup> See Office of the Inspector General, SSA, *Personally Identifiable Information Made Available to the General Public Via the Death Master File*, A-06-08-18042 (June 2008).

<sup>10</sup> *Dep’t of Justice v. Reporters Comm. for Freedom of Press*, 489 U.S. 749, 772-73 (1989).

<sup>11</sup> We acknowledge that there may be some value in accessing the DMF to gain insight into the SSA. For example, an enterprising reporter could utilize DMF information to show that the SSA’s records are grossly inaccurate by tracking down how many of the people listed there are actually still living. This may show that the SSA’s method of recordkeeping is seriously flawed. However, one could make such a finding even with partial access to the DMF or if access was delayed a couple of years.

<sup>12</sup> *Schrecker v. Dep’t of Justice*, 254 F.3d 162, 166 (D.C. Cir. 2001).

<sup>13</sup> *Accuracy in Media, Inc. v. Nat’l Park Serv.*, 194 F.3d 120, 123 (D.C. Cir. 1999) (relating to suicide of White House official Vince Foster).

<sup>14</sup> *National Archives & Records Admin. v. Favish*, 541 U.S. 157, 169 (2004) (finding that “well-established cultural tradition acknowledging a family’s control over the body and death images of the deceased has long been recognized at common law” with respect to suicide of White House official Vince Foster).

<sup>15</sup> *New York Times v. NASA*, 920 F.2d 1002, 1005 (D.C. Cir. 1990) (*en banc*).

## REASONS FOR CHANGE

The National Taxpayer Advocate is appalled that the federal government is making sensitive personal information so readily available to those who steal the identities of deceased individuals and add to the burden and heartbreak facing their survivors. Perhaps most worrisome, the DMF contributes to tax-related identity theft by providing the date of birth and SSN, allowing thieves to target decedents who were minors and can be claimed as dependents.

When the 1980 consent judgment was entered, identity theft was not a significant problem. Today, heightened identity theft not only imposes a considerable hardship on victims or their families, but it also costs the government money and resources. Moreover, much of the case law affecting the public-private analysis had not yet been established in 1980, especially the narrowing of the public interest to be served by the disclosed information. A contemporary balancing test between the public's right to the DMF data and the privacy rights of the decedents' families may yield different results than the same test applied 31 years ago. While DMF data has some legitimate users (such as pension administrators who rely on DMF data to terminate payments and genealogists), there is a compelling public interest in keeping such information out of the public domain.

Recently, several genealogy websites have voluntarily agreed to curtail the availability of the Death Master File information. Ancestry.com announced in December 2011 that it will no longer display SSNs for anyone who has passed away within the past ten years.<sup>16</sup> RootsWeb.com, another genealogy site affiliated with Ancestry.com, states that it will not share information from the DMF "due to sensitivities around the information in this database."<sup>17</sup> While these voluntary changes should make it more difficult for identity thieves to file false tax returns, the National Taxpayer Advocate requests that Congress enact legislation to restrict access to the DMF to those with a legitimate need for such sensitive information.

## EXPLANATION OF RECOMMENDATION

Congress could take one of several approaches to restrict access to the DMF. One approach is to create an exemption under FOIA, which is proposed in S. 1534.<sup>18</sup> This bill would restrict who can access the DMF and impose penalties for unauthorized re-disclosure. Recipients of the DMF would be required to certify that they have a legitimate

<sup>16</sup> See Ancestry.com, *Why Was the Social Security Death Index Recently Changed?*, [http://ancestry.custhelp.com/cgi-bin/ancestry.cfg/php/enduser/sab\\_answer.php?p\\_faqid=5420&p\\_created=1323809913&p\\_sid=utw11BLk&p\\_accessibility=&p\\_redirect=&p\\_lva=&p\\_sp=cF9zcmNoPTEmcF9zb3J0X2J5PSZwX2dyaWRzb3J0PSZwX3Byb2RzPSZwX2NhdHM9JnBfcHY9JnBfY3Y9JnBfcGFnZT0x&p\\_li=&p\\_topview=1](http://ancestry.custhelp.com/cgi-bin/ancestry.cfg/php/enduser/sab_answer.php?p_faqid=5420&p_created=1323809913&p_sid=utw11BLk&p_accessibility=&p_redirect=&p_lva=&p_sp=cF9zcmNoPTEmcF9zb3J0X2J5PSZwX2dyaWRzb3J0PSZwX3Byb2RzPSZwX2NhdHM9JnBfcHY9JnBfY3Y9JnBfcGFnZT0x&p_li=&p_topview=1) (last visited Dec. 19, 2011).

<sup>17</sup> See About.com, *Genealogy Sites Pressured Into Removing SSDI*, <http://genealogy.about.com/b/2011/12/16/genealogy-sites-pressured-into-removing-ssdi.htm> (last visited Dec. 19, 2011); Ancestry.com, *Why Was the Social Security Death Index Recently Changed?*, [http://ancestry.custhelp.com/cgi-bin/ancestry.cfg/php/enduser/sab\\_answer.php?p\\_faqid=5420&p\\_created=1323809913&p\\_sid=utw11BLk&p\\_accessibility=&p\\_redirect=&p\\_lva=&p\\_sp=cF9zcmNoPTEmcF9zb3J0X2J5PSZwX2dyaWRzb3J0PSZwX3Byb2RzPSZwX2NhdHM9JnBfcHY9JnBfY3Y9JnBfcGFnZT0x&p\\_li=&p\\_topview=1](http://ancestry.custhelp.com/cgi-bin/ancestry.cfg/php/enduser/sab_answer.php?p_faqid=5420&p_created=1323809913&p_sid=utw11BLk&p_accessibility=&p_redirect=&p_lva=&p_sp=cF9zcmNoPTEmcF9zb3J0X2J5PSZwX2dyaWRzb3J0PSZwX3Byb2RzPSZwX2NhdHM9JnBfcHY9JnBfY3Y9JnBfcGFnZT0x&p_li=&p_topview=1) (last visited Dec. 19, 2011); Scripps Howard News Service, *Genealogy Sites Remove Social Security Numbers of Deceased* (Dec. 15, 2011), available at <http://www.abcactionnews.com/dpp/news/national/genealogy-sites-remove-social-security-numbers-of-deceased>.

<sup>18</sup> Identify Theft and Tax Fraud Prevention Act, S. 1534, 112th Cong. § 9 (1st Sess. 2011).

fraud-prevention interest in accessing the DMF and be subject to a penalty of \$1,000 for re-disclosure or misuse of the information.<sup>19</sup>

Alternatively, Congress could adopt the approach it uses to govern the confidentiality and disclosure of tax return information. In that situation, Congress established a general rule that tax return information will be kept confidential and has delineated a number of exceptions to the rule.<sup>20</sup> This approach could produce the same result as S. 1534, allowing the government to provide DMF information to entities with a demonstrated fraud-prevention purpose and imposing significant penalties for unauthorized re-disclosures. It could also make all or substantially all DMF information public after a specified number of years so that genealogists may access it.<sup>21</sup>

Finally, Congress could mandate that a truncated version of the SSN (*e.g.*, only the last four digits) be included in the DMF to prevent the theft and misuse of the decedents' identities. Because the release of full SSNs substantially furthers criminal conduct and affects the public fisc, the benefits of partially redacting SSNs may outweigh those of releasing the complete numbers. However, this approach may disclose enough information to permit some amount of identity theft and might be inadequate for pension administrators and other anti-fraud users who rely on full SSNs. Therefore, this approach would require further study.

<sup>19</sup> Identify Theft and Tax Fraud Prevention Act, S. 1534, 112th Cong. § 9(c) (1st Sess. 2011).

<sup>20</sup> See *generally* Internal Revenue Code § 6103.

<sup>21</sup> Typically, decedents have a final tax filing requirement in the year of death. See IRS Publication 559, *Survivors, Executors, and Administrators* 4 (Mar. 2011). A surviving spouse may be able to file as a qualifying widow(er) using the Married Filing Jointly tax rates for two years following the spouse's death. The IRS could retire the SSNs of decedents in the third year after death and thus block any returns with those numbers in later years.

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## Mandate That the IRS, in Conjunction with the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights

### PROBLEM

Internal Revenue Code (IRC) § 6213, in subsections (b) and (g), authorizes the IRS to use its math error authority to summarily assess tax and bypass normal deficiency procedures. From the outset, Congress has made clear that use of math error authority is meant to be limited in scope and should not be used to resolve an uncertainty against the taxpayer.<sup>1</sup>

Originally, math error authority was intended to apply only to simple mathematical and clerical errors.<sup>2</sup> Over the years, however, Congress has expanded its use to a compliance context. The IRS employs it to disallow improper claims where the entry on a tax return conflicts with information from a database or other records.<sup>3</sup> Using math error authority for this additional purpose can be an efficient way to correct inadvertent errors.<sup>4</sup>

Both the Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office (GAO) have recently encouraged the IRS to increase its use of math error authority as a cost-effective way to process certain new items on returns.<sup>5</sup> Although some of the GAO and TIGTA proposals may be appropriate uses of math error authority, it is essential that the IRS conduct a full analysis to ensure that any future expansion of math error authority does not increase taxpayer burden, erode taxpayer rights and protections, and create IRS rework.<sup>6</sup> For taxpayers, this burden could include an IRS adjustment that improperly reduces a refund and delays the release of the correct amount. Additionally, using math error authority for complex, fact-intensive provisions means that math error notices may become more complex. A complex notice could discourage a prompt taxpayer response, which would cause the taxpayer to lose the right to challenge the adjustment in the United States Tax Court (the only forum that does not require the taxpayer to pay the liability before adjudication). For the IRS, additional burden could take the form of increased calls, the need to abate assessments and reprocess returns, and, if the taxpayer

<sup>1</sup> IRC § 6213(g)(2).

<sup>2</sup> H.R. Rep. No. 94-658, 94th Cong., 2d Sess. § 1203, at 291 (Nov. 12, 1975).

<sup>3</sup> IRC § 6213(g)(2). There are now 16 Code provisions giving the IRS the authority to make math error adjustments.

<sup>4</sup> See *Hearing on Improper Payments in the Administration of Refundable Tax Credits Before the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives* 26, 112th Cong. (May 25, 2011) (statement of Nina E. Olson, National Taxpayer Advocate). The National Taxpayer Advocate acknowledges that certain third-party data may appropriately be used in math error adjustments and has previously identified the type of expansions she would consider appropriate. These expansions include the use of the Social Security Administration's (SSA) NUMIDENT database to supply birthdates and Social Security numbers, and the use of IRS internal databases to determine if a taxpayer can claim a credit or has reached a limit (e.g., can an adoption credit be claimed in another year or has a taxpayer reached an applicable monetary limit).

<sup>5</sup> TIGTA, Ref. No. 2011-40-059, *Some Taxpayer Responses to Math Error Adjustments Were Not Worked Timely and Accurately* (July 7, 2011); GAO, GAO 10-349, *Recovery Act; IRS Quickly Implemented Tax Provisions, but Reporting and Enforcement Improvements Are Needed* (Feb. 2010).

<sup>6</sup> See Most Serious Problem: *Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights*, *supra*.

does not contact the IRS within the prescribed 60 days, assigning the case to the Collection function.

Similarly, using math error authority when the information on a taxpayer's return does not match specified third-party information can increase burden and erode taxpayers' rights if the information is not reliable or suitable. Congress has recognized this risk by constraining IRS use of such third-party databases in similar circumstances.<sup>7</sup>

## RECOMMENDATIONS

To ensure that IRS use of math error authority does not impair taxpayers' rights and minimizes burden to both the taxpayer and the IRS, the National Taxpayer Advocate recommends that Congress require the IRS to develop math error notices that clearly describe what is being changed and why, and tell the taxpayer what steps he or she should take to contest the change. The National Taxpayer Advocate further recommends that Congress consider the following issues in connection with any future expansions of math error authority under IRC § 6213(g):

1. Confine use of math error authority to instances that are not factually complex, can be verified on accurate, reliable government databases, and do not require the IRS to analyze facts and circumstances or weigh the adequacy of information.
2. Permit the IRS to use math error authority in conjunction with private third-party databases only where the information has been identified as reliable and accurate, and thus, would not subject the IRS to constraints in litigation.<sup>8</sup>
3. Restrict math error authority in situations with a high abatement rate, where the use of math error authority appears to be unduly burdening compliant taxpayers by requiring them to submit additional documentation within a 60-day timeframe compared to a 90-day timeframe when deficiency procedures are used.

To ensure that future grants of math error authority observe these limits, the National Taxpayer Advocate recommends that Congress require the Department of Treasury, in conjunction with the National Taxpayer Advocate, to evaluate and report to Congress on whether any proposed expansions satisfy these criteria. The report should analyze the burdens and benefits of the proposed use of math error authority, considering downstream costs such as those for audit reconsideration and TAS intervention, and rigorously analyze the proposed expansions for accuracy and suitability.

<sup>7</sup> Congress enacted IRC § 6201(d) following the decision in *Portillo v. Comm'r*, 932 F.2d 1128 (5th Cir. 1991). Section 6201(d) places the burden of production in litigation on the Commissioner where the taxpayer raises a reasonable dispute concerning certain information returns supplied by third parties. In *Portillo*, the court found the IRS's determination that the taxpayer had received unreported income of \$24,505 was arbitrary and erroneous, because a Form 1099 sent to the IRS by another taxpayer was the sole basis for the determination. The court concluded that the IRS had a duty to investigate the accuracy of the form and determine if it could be verified by other information, such as the books or records of the taxpayer who submitted it. The court held the IRS did issue a valid deficiency notice, but determined that notice to be arbitrary and erroneous, because the IRS failed to substantiate the charge that the taxpayer had unreported income.

<sup>8</sup> *Portillo v. Comm'r*, 932 F.2d 1128 (5th Cir. 1991).

## EXAMPLE

Under IRC §36(d)(4), to be eligible for the First-Time Homebuyer Credit (FTHBC), a taxpayer must attach a copy of a properly executed settlement statement to the return. IRC § 6213(g)(2)(P) granted the IRS math error authority to deny the credit where the taxpayer failed to attach the statement. Initially, the IRS deemed a settlement statement properly executed if it showed all parties' names and signatures, the property address, sales price, and date of purchase. Normally, Form HUD-1, *Settlement Statement*, would meet these criteria.<sup>9</sup> If the statement omitted this information, the IRS considered it not properly executed, and disallowed the FTHBC using math error authority. As a result, the IRS denied the FTHBC to many taxpayers in states that did not require statements to display all of this information. On finding that complete addresses are not required by all states, the IRS reversed its position, allowed FTHBC claims lacking complete addresses,<sup>10</sup> and now considers settlement statements valid without the buyers' and sellers' signatures.<sup>11</sup> But to make this and other determinations about the sufficiency of the settlement statement, the IRS must review the actual settlement statement, which must be filed with a paper return, thereby eliminating the efficiencies of math error processing and burdening taxpayers. A far better approach for both the IRS and taxpayers would be to limit FTHBC math error authority to determine whether a document that purports to be the settlement statement was actually attached to the return (*i.e.*, a simple yes/no determination), and leave the facts-and-circumstances determination of the *sufficiency* of the settlement statement to normal deficiency procedures.

## PRESENT LAW

### *Status of Math Error Authority*

Sixteen statutory provisions give the IRS the authority to make math error adjustments.<sup>12</sup> Summary assessments made under these provisions can be abated if the taxpayer timely requests abatement.<sup>13</sup> The IRS will then work the case through normal deficiency procedures.<sup>14</sup>

### *Evolution of Math Error Authority*

Upon enactment, IRS math error authority was limited to simple situations with a clear mathematical or clerical error, specifically to "inconsistencies where it can be determined

<sup>9</sup> IRS News Release IR-2010-006, New Homebuyer Credit Form Released; Taxpayers Reminded to Attach Settlement Statements and Other Key Documents (Jan. 15, 2010), <http://www.irs.gov/newsroom/article/0,,id=218336,00.html> (last visited Dec. 27, 2011).

<sup>10</sup> See IRS SERP Alert 100290 (May 25, 2010).

<sup>11</sup> IRM 21.6.3.4.2.11.6 (6) (Servicewide Electronic Research Program (SERP) update Apr. 18, 2011). See also IRS SERP Alert 100066 (Feb. 12, 2010). Mobile home purchasers may submit an executed retail sales contract including the names, address, purchase date, purchase price, and signatures of both taxpayers, if applicable. If the home is newly constructed, a copy of the occupancy permit is sufficient.

<sup>12</sup> IRC § 6213(g)(2)(A) - (P).

<sup>13</sup> IRC § 6213(b)(2)(A).

<sup>14</sup> *Id.*

from the face of the return which inconsistencies are correct.”<sup>15</sup> Further, the mathematical or clerical inconsistencies were to be apparent.<sup>16</sup>

The legislative history elaborated on what Congress considered a mathematical error or inconsistent treatment on a return. “Mathematical” errors include “errors in addition, subtraction, etc.” where “such an error will be apparent and the correct answer will be obvious.”<sup>17</sup> Congress added that the term “inconsistent treatment on a return” was intended to “encompass those cases where it is apparent which of the inconsistent entries is correct and which is incorrect.”<sup>18</sup> Congress also made it clear that the IRS is not to use summary assessment procedures merely to resolve an uncertainty against the taxpayer.<sup>19</sup>

Congress narrowly defined math and clerical error in part so that taxpayers might easily understand what was being adjusted. The following example is based on a scenario taken from the legislative history. It is an example using math error authority to correct a straightforward mistake and shows the level of clarity Congress expected in IRS math error notices.

**Example:** A notice regarding an inconsistency in the number of dependents listed on the taxpayer’s return might read: “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>20</sup>

The legislative history also provides specific guidance on what protections are given the taxpayer when the IRS uses summary assessment procedures:

The amendment provides that where the Internal Revenue Service uses the summary assessment procedure for mathematical errors... the taxpayer must be given an explanation of the asserted error... , the taxpayer must be given a period of time during which he or she may require the Service to abate its assessment ... , and the Service is not to proceed to collect on the assessment until the taxpayer has agreed to the assessment or has allowed his or her time for objecting to expire... .<sup>21</sup>

This legislative history illustrates the importance Congress placed on providing taxpayers with notices that adequately explain the adjustments to their returns. However, preserving

<sup>15</sup> IRC § 6213(g)(2)(C).

<sup>16</sup> IRC § 6213(g)(2)(B).

<sup>17</sup> IRC § 6213(g)(2). This provision memorialized what Congress expressed in the legislative history. See also H.R. Rep. No. 94-658, 94th Cong., 2d Sess. § 1203, at 291 (Nov. 12, 1975).

<sup>18</sup> H.R. Rep. No. 94-658, 94th Cong., 2d Sess. § 1203, at 291 (Nov. 12, 1975).

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> S. Rep. No. 938, 94th Cong., 2d Sess. 375 (1976); 1976-3 (Vol. 3) C.B. 49, 413.

this taxpayer protection becomes more difficult as new, complicated provisions fall under math error authority.<sup>22</sup>

### *Authorized Use of Third-Party Data*

In certain situations, the IRS can use third-party data, including information provided by the Social Security Administration (SSA), to identify omitted Taxpayer Identification Numbers (TINs) and make math error adjustments based on that information.<sup>23</sup> The statute also permits the IRS to use the Federal Case Registry of Child Support Orders (FCR) to determine whether a taxpayer is a custodial parent of a child for purposes of the earned income tax credit (EITC).<sup>24</sup> Although the IRS is legally permitted to use this registry, the IRS has refrained from doing so due to concerns raised by the National Taxpayer Advocate about its accuracy, which were later validated by an IRS study.<sup>25</sup>

## REASON FOR CHANGE

As the IRS's resources decrease, it seeks to expand math error authority in new areas as a cost-effective way to protect revenue, particularly where a credit can generate a large refund. This is especially true since the IRS assumes disbursement as well as revenue collection duties and is responsible for preventing large, refundable credits from being improperly issued. Some math error expansions under consideration include the use of third-party data provided by federal agencies other than the SSA, or even outside sources.<sup>26</sup> The National Taxpayer Advocate acknowledges that math error authority can be an appropriate way to stop improper refunds. However, it is crucial, prior to granting expanded authority, that a thorough analysis of the potential impact on taxpayers and the IRS be conducted. Thorough analysis will allow the IRS to avoid inappropriate reliance on databases, such as the FCR. Failing to conduct a thorough review may cause problems similar to those the IRS recently experienced when it inappropriately disallowed the FTHBC through summary assessments, as illustrated in the example above.<sup>27</sup>

<sup>22</sup> IRC § 36. An adjustment to a FTHBC credit is an example of the type of provision that may be challenging to explain clearly in a math error notice.

<sup>23</sup> IRC § 6213(g)(2) provides that a taxpayer shall be treated as having omitted a correct TIN if the information on the return with respect to the individual whose TIN was provided is different from the information the IRS obtains from the SSA.

<sup>24</sup> IRC § 6213(g)(2)(M).

<sup>25</sup> See National Taxpayer Advocate 2002 Annual Report to Congress 189 (Legislative Recommendation: *Math Error Authority*). Congress mandated that the IRS complete a study in conjunction with the National Taxpayer Advocate before implementing the use of the FCR; the study demonstrated that the FCR was unreliable and the IRS did not implement that math error authority. See IRS, *Federal Case Registry Final Report*, Project 5-02-12-3-005 (CR-39) (Sept. 2003); see also *Hearing on Improper Payments in the Administration of Refundable Tax Credits Before the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives* 26, 112th Cong. (May 25, 2011) (statement of Nina E. Olson, National Taxpayer Advocate).

<sup>26</sup> IRS Briefing, Overview of the Accelerated Refund Assurance Program (ARAP) (Oct. 6, 2011).

<sup>27</sup> National Taxpayer Advocate FY 2011 Objectives Report 28 (Filing Season Review).

## EXPLANATION OF RECOMMENDATION

Having the Treasury Department, along with the National Taxpayer Advocate, analyze math error proposals will help identify if the proposal complies with the limitations set out above. This analysis will ultimately determine if summary assessment or deficiency procedures would be more suitable. The GAO previously made a similar recommendation.<sup>28</sup>

### *Facts-and-Circumstances Determinations Should Be Subject to Normal Deficiency Procedures.*

The use of math error authority has become an attractive, cost-effective way to prevent improper refunds from being distributed. However, many of the provisions that generate these refunds have complicated eligibility requirements that vary according to a taxpayer's facts and circumstances. Limiting math error authority in these cases will prevent the types of problems both the IRS and taxpayers experienced with the FTHBC and will stop the IRS from using math error to "resolve an uncertainty against the taxpayer."

### *Notices Would Be Required to Clearly Identify What Is Being Changed, the Reason for the Change, and What Steps the Taxpayer Should Take in Order to Contest the Change.*

Use of math error authority in complex facts-and-circumstances situations makes it more difficult to draft notices that explain clearly what has been changed and why. This lack of clarity may confuse taxpayers, which in turn can delay a refund or result in the taxpayer losing his or her right to dispute the adjustment in the U.S. Tax Court. Therefore, the IRS should be required to demonstrate, prior to receiving math error authority, that it can draft clear notices with respect to that provision.

### *Some Third-Party Information Is Too Unreliable to Use for the Purpose of Math Error.*

Third-party data must be reliable and complete, and meet the standards elsewhere observed by the courts and Congress,<sup>29</sup> if it is used to verify information on a taxpayer's return and make a summary assessment based on that data. The FCR, which the IRS was granted authority by Congress to use to determine whether a taxpayer is a custodial parent of a child for purposes of the earned income tax credit, is an example of an unreliable third-party database, because it was designed for an entirely different purpose. Such reliability concerns also exist for proposals to use certain state databases to determine eligibility, especially with respect to an individual's status as a qualifying child for EITC purposes, which is a complicated determination that requires a determination of the child's residence for more than half the year – a circumstance that may shift from year-to-year and is highly fact-specific. Further, if the information in the database was compiled for a different purpose, the use may not be appropriate, because the data may not disprove eligibility under the tax law. Moreover, the information may be outdated, and it should not deprive a taxpayer of a due

<sup>28</sup> GAO, GAO-11-691T, *Enhanced Prerefund Compliance Checks Could Yield Significant Benefits* (May 25, 2011).

<sup>29</sup> IRC § 6201(d).

process right to present his or her own facts. Such data may not be accurate enough for the IRS to rely on in litigation.<sup>30</sup> Although the database cannot be relied upon when making a summary assessment, it still may be useful as an indicator that the IRS should look more closely at the return in an examination — not math error — context.

***Reliable Data Is Useful in Certain Math Error Situations.***

Use of external data is appropriate for making math error assessments in limited circumstances, namely when the data is reliable and its use will not lead to improper summary assessments. An example of appropriate use of this expanded authority is the use of the Social Security Administration's NUMIDENT database.<sup>31</sup>

It is also appropriate for the IRS to exercise math error authority based on its own internal data (prior-year tax returns), as recommended by GAO in the following two situations.

1. To verify compliance with lifetime limits on amounts that can be claimed, such as for the Residential Energy Credit.<sup>32</sup> This would permit the IRS to verify that the credits claimed for 2009 and 2010 do not exceed the lifetime credit limit of \$1,500.<sup>33</sup>
2. To determine whether a taxpayer exceeded the number of years in which the Hope Scholarship credit can be claimed.<sup>34</sup>

The National Taxpayer Advocate supports these recommendations because the IRS would be using reliable information to make the summary assessments.

<sup>30</sup> *Portillo v. Comm'r*, 932 F.2d 1128 (5th Cir. 1991).

<sup>31</sup> See IRM 2.3.32.8 (July 1, 2008); IRM exhibit 2.3.32-17 (Jan. 1, 2005). NUMIDENT information is a complete history of changes, such as name changes, as reported to SSA by the user of the SSA account number.

<sup>32</sup> GAO, GAO 11-481, *IRS Dealt with Challenges to Date, but Needs Additional Authority to Verify Compliance* (Mar. 2011).

<sup>33</sup> The American Recovery and Reinvestment Act of 2009 limited the aggregate amount of credit for taxable years beginning in 2009 and 2010 to \$1,500. Pub. L. No. 111-5, § 121, 123 Stat. 115, 322 (Feb. 17, 2009) (amending IRC § 25C).

<sup>34</sup> GAO, GAO-11-691T, *Enhanced Prerefund Compliance Checks Could Yield Significant Benefits* (May 25, 2011). The Hope Scholarship Credit under IRC § 25A was modified by the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5. For tax years beginning in 2009 or 2010, the credit was available for the first four years of a student's post-secondary education. See Pub. L. No. 111-5, § 1004(a), 123 Stat. 115, 313 (Feb. 17, 2009). The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended the credit to tax years beginning in 2011 and 2012. Pub. L. No. 111-312, § 103, 124 Stat. 3296, 3299 (Dec. 17, 2010).

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## Clarify that the Scope and Standard of Tax Court Determinations Under Internal Revenue Code Section 6015(f) is *De Novo*

### PROBLEM

Married taxpayers who file joint returns are jointly and severally liable for any deficiency or tax due.<sup>1</sup> An “innocent spouse” statute, Internal Revenue Code (IRC) § 6015, provides for relief from deficiencies in the specific circumstances as described in subsections (b) and (c). If relief is unavailable under subsection (b) or (c), a taxpayer may qualify for “equitable” innocent spouse relief from deficiencies and underpayments pursuant to subsection (f).<sup>2</sup> Relief under IRC § 6015(f) is appropriate when, taking into account all the facts and circumstances, it would be inequitable to hold a joint filer liable for the unpaid tax or deficiency. IRS guidance enumerates various factors that should be considered and may weigh in favor of or against granting equitable relief.<sup>3</sup>

The Tax Court, in *Porter v. Commissioner (Porter I)*, held that the *scope* of its review in IRC § 6015(f) cases is *de novo*, meaning that it may consider evidence introduced at trial that was not included in the administrative record.<sup>4</sup> In *Porter v. Commissioner (Porter II)*, the Tax Court held that the *standard* of review in IRC § 6015(f) cases is also *de novo*, meaning that it will consider the case anew, without deference to the agency determination to deny relief.<sup>5</sup> The IRS Office of Chief Counsel disagrees with the Tax Court’s decisions in *Porter I* and *Porter II*. Its position is that the proper standard of review is abuse of discretion, and the scope of the Tax Court’s review is limited to the administrative record.<sup>6</sup> This divergence creates uncertainty for taxpayers and consumes administrative and judicial resources. It is especially harmful to taxpayers who cannot afford representation or assistance during administrative proceedings. Therefore, the National Taxpayer Advocate recommends that Congress clarify that the scope and standard of review in Tax Court determinations under IRC § 6015(f) is *de novo*.

<sup>1</sup> Internal Revenue Code (IRC) § 6013(d)(3); Rev. Proc. 2003-61, 2003-2 C.B. 296.

<sup>2</sup> A deficiency is generally the difference between the amount of tax that should have been shown on the return and the amount that was actually shown. See IRC § 6213. “Underpayment” refers to the tax shown on the return but not paid.

<sup>3</sup> Rev. Proc. 2003-2 C.B. 296, *superseding* Rev. Proc. 2000-15, 2000-1 C.B. 447.

<sup>4</sup> 130 T.C. 115 (2008) (*Porter I*). In *Neal v. Comm’r*, 557 F.3d 1262 (11th Cir. 2009), *aff’g* T.C. Memo. 2005-201, a court of appeals also held that the appropriate scope of Tax Court review in IRC § 6015(f) cases is *de novo*.

<sup>5</sup> 132 T.C. 203 (2009) (*Porter II*). The issue of the appropriate standard of review in IRC § 6015(f) cases is pending in *Wilson v. Comm’r*, T.C. Memo. 2010-134, *appeal docketed*, No.10-72754 (9th Cir. Sept. 10, 2010).

<sup>6</sup> Notice CC-2009-021 (June 30, 2009) states “In all section 6015(f) cases the proper standard of review is abuse of discretion. Attorneys should, therefore, continue to argue that, under an abuse of discretion standard of review, the scope of the Tax Court’s review is limited to issues and evidence presented before Appeals or Examination. Attorneys should raise the scope and standard of review arguments whenever appropriate...noting the Service’s disagreement with the holding in the *Porter* opinions.”

**EXAMPLE**

*Wilson v. Commissioner*<sup>7</sup> illustrates how the Tax Court's independent fact finding and analysis in *de novo* review can produce a different outcome than a decision based only on the administrative record with deference to the IRS's determinations. In that case, Mrs. Wilson's spouse, with whom she filed a joint return, generated additional income by steering people into a Ponzi scheme. Mrs. Wilson was aware of the additional income, which was reported on amended joint returns she signed, but believed it derived from legitimate business operations. Without the assistance of counsel or another representative, she requested equitable relief under IRC § 6015(f) from the underpayment.

Mrs. Wilson was married when she requested equitable innocent spouse relief, a factor that weighs neither for nor against granting relief. The administrative record showed that, among other things, she had made a good faith effort to comply with the tax laws after the years covered by her request for relief, a factor that weighs in favor of granting relief. However, Mrs. Wilson did not substantiate her expenses in support of her claim that she would suffer economic hardship if relief was not granted, and the administrative record contained little information that would establish the size of the tax liability attributable to her husband. Mrs. Wilson did not respond to the IRS's request for an explanation of what she knew when she signed the returns. The IRS, finding that Mrs. Wilson had not shown that she did not know or have reason to know the tax would not be paid, and in view of the other circumstances of the case, denied her request for relief.

Mrs. Wilson petitioned the Tax Court for review, and represented herself ineffectively at a 2005 trial.<sup>8</sup> The Tax Court arranged for *pro bono* counsel and over the IRS's objection, reopened the record and held a second trial in 2008.<sup>9</sup> By the time the Tax Court considered Mrs. Wilson's case in 2008, she was no longer married, which changed the marital status factor to weigh in her favor. Although Mrs. Wilson was not able to prove that she had made a good faith effort to comply with the tax laws in the intervening years, which weighed against granting relief, she introduced evidence about the couple's income and assets during the years at issue, which satisfied the court that she reasonably believed the liability would be paid. The court also accepted Mrs. Wilson's credible testimony about her lifestyle, living expenses, and uncertain financial future at the time of trial and concluded that she would suffer economic hardship if relief were not granted. Based on the evidence in the administrative record and the facts developed at trial, the Tax Court found that the tax liability was attributable entirely to Mr. Wilson. In view of these circumstances and under a *de novo* standard of review, the Tax Court granted Mrs. Wilson's request for equitable relief.

<sup>7</sup> T.C. Memo. 2010-134, *appeal docketed*, No.10-72754 (9th Cir. Sept. 10, 2010).

<sup>8</sup> The Tax Court describes Mrs. Wilson's *pro se* representation as follows: "This excerpt from the transcript of the first trial was typical: 'Call your first witness, then.' 'I have no witnesses.' 'Well, how about yourself?' 'Okay.' 'You count.' 'I count?' 'Yes.'" *Wilson v. Comm'r*, T.C. Memo. 2010-134, 2 n.2.

<sup>9</sup> See Reply Brief for Respondent 3-11, *Wilson v. Comm'r*, T.C. Memo. 2010-134 (No. 23882-04), 2007 WL 7231341.

## RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6015 to specify that the scope and standard of review in Tax Court determinations under IRC § 6015(f) is *de novo*.

## CURRENT LAW

The innocent spouse rules of IRC § 6015 were enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998.<sup>10</sup> If the IRS denies relief under any subsection of IRC § 6015, the taxpayer may petition the Tax Court.<sup>11</sup> The IRS Office of Chief Counsel maintains that the proper standard of review in all IRC § 6015 cases is abuse of discretion, and that the scope of review is limited to issues and evidence presented before IRS Appeals or Examination.<sup>12</sup>

### Scope of Review

In *Ewing v. Commissioner*, the Tax Court held that the scope of its review in IRC § 6015(f) cases would be *de novo*.<sup>13</sup> The holding was based on the finding that the Administrative Procedure Act, which limits the scope of judicial review to the administrative record, was not applicable to Tax Court proceedings, including IRC § 6015 proceedings.<sup>14</sup> Further, the Tax Court found the use of the word “determine” in IRC § 6015(e) is similar to the use of “redetermination” in IRC § 6213(a), pertaining to deficiencies, under which it is unquestioned that the court conducts trials *de novo*. The Tax Court concluded that the use of this term meant that Congress intended the court to have *de novo* review authority for IRC § 6015(f) cases, even if they do not involve deficiencies.<sup>15</sup>

The *Ewing* case was a stand-alone proceeding: Mrs. Ewing had not requested innocent spouse relief in response to a statutory notice of deficiency but rather in response to the IRS’s determination that she was not entitled to equitable relief. The Tax Court, at an earlier stage of the proceedings, had already considered the question of whether it had jurisdiction to review Mrs. Ewing’s petition, and found that it did.<sup>16</sup> However, on appeal,

<sup>10</sup> Pub. L. No. 105-206, sec. 3201(a), (b), 112 Stat. 685 at 734, 739 (1998).

<sup>11</sup> In addition to the Tax Court’s jurisdiction to redetermine deficiencies under IRC § 6213, IRC § 6015(e) provides that the Tax Court has jurisdiction to determine the appropriate relief available under IRC § 6015 if the petition is filed in response to the IRS’s final determination or after the claim for innocent spouse relief has been pending with the IRS for six months and no final determination has been issued. The filing of a Tax Court petition where jurisdiction is predicated on IRC § 6015(e) and not on deficiency jurisdiction under IRC § 6213 is often referred to as a stand-alone proceeding.

<sup>12</sup> Notice CC-2009-021 (June 30, 2009).

<sup>13</sup> 122 T.C. 32 (2004), *vacated on other grounds sub nom. Comm’r v. Ewing*, 439 F.3d 1009 (9th Cir. 2006).

<sup>14</sup> 122 T.C. at 35, 37-38 (citing 5 U.S.C. §§ 551-559, 701-706 (2000)).

<sup>15</sup> The Tax Court also noted that some proceedings in IRC § 6015(f) cases could not be based on the administrative record. For example, if a taxpayer petitions the Tax Court after the request for relief has been pending for six months, as permitted by IRC § 6015(e)(1)(A)(i)(II), there may be no administrative record. As another example, a taxpayer may, in a deficiency proceeding, raise IRC § 6015(f) as an affirmative defense. Again, there would be no administrative record to consult, and the scope of review would be *de novo*. The Tax Court deemed it anomalous to use different standards to decide the same issue simply because of differences in the procedural posture in which the issue was brought before the court. Moreover, Congress provided for intervention by nonrequesting spouses, which suggests it intended trials *de novo* under IRC § 6015(f) to permit the other spouse to offer evidence.

<sup>16</sup> *Ewing v. Comm’r*, 118 T.C. 494 (2002), *rev’d. sub nom. Comm’r v. Ewing*, 439 F.3d 1009 (9th Cir. 2006).

the Ninth Circuit Court of Appeals found that the Tax Court lacked jurisdiction over stand-alone cases under IRC § 6015(f).<sup>17</sup> It therefore reversed the Tax Court's earlier decision that it had jurisdiction over the claim, and vacated the Tax Court's decision pertaining to scope of review.<sup>18</sup> Congress then amended IRC § 6015(e) to make explicit that the Tax Court does have jurisdiction in stand-alone IRC § 6015(f) cases.<sup>19</sup>

The issue of scope of review again arose in *Porter I*, and the Tax Court, drawing heavily on its reasoning in *Ewing*, again held that the appropriate scope of review is *de novo*.<sup>20</sup> The IRS did not appeal the Tax Court's decision in *Porter I*, and the court continued to hold that the proper scope of review was *de novo*.<sup>21</sup> When the IRS appealed one such decision, *Neal v. Commissioner*, the Eleventh Circuit Court of Appeals affirmed the Tax Court's holding that its scope of review is *de novo*.<sup>22</sup>

The IRS maintains that *de novo* review of IRC § 6015(f) cases is not appropriate.<sup>23</sup> It analogizes IRC § 6015(f) proceedings to collection due process determinations under IRC § 6330.<sup>24</sup> The IRS has successfully established in two courts of appeal that Tax Court

<sup>17</sup> The Ninth Circuit found that because the IRS never determined a deficiency against Mrs. Ewing and her husband, the Tax Court lacked jurisdiction. At the time of this appellate court decision, IRC § 6015(e), the provision authorizing Tax Court review of innocent spouse cases, provided "In the case of an individual *against whom a deficiency has been asserted* and who elects to have subsection (b) or (c) apply-

(A) In general.-In addition to any other remedy provided by law, the individual may petition the Tax Court (and the Tax Court shall have jurisdiction) to determine the appropriate relief available to the individual under this section..." (emphasis added);

See also *Bartman v. Comm'r*, 446 F.3d 785, 787 (8th Cir. 2006), *affg. in part and vacating in part* T.C. Memo. 2004-93, and *Billings v. Comm'r*, 127 T.C. 7 (2006) (holding that the Tax Court lacked jurisdiction over stand-alone IRC § 6015(f) claims).

<sup>18</sup> *Comm'r v. Ewing*, 439 F.3d 1009 (9th Cir. 2006).

<sup>19</sup> The Tax Relief and Health Care Act of 2006 (TRHCA), Pub. L. No. 109-432, Div. C, § 408(a), (c), 120 Stat. 2922, 3061-62 (2006), amended IRC § 6015(e) to expressly provide that the Tax Court has jurisdiction to review stand-alone cases under IRC § 6015(f), even where no deficiency has been asserted. IRC § 6015(e) now provides "In the case of an individual against whom a deficiency has been asserted and who elects to have subsection (b) or (c) apply, or in the case of an individual who requests equitable relief under subsection (f)--

(A) In general. -In addition to any other remedy provided by law, the individual may petition the Tax Court (and the Tax Court shall have jurisdiction) to determine the appropriate relief available to the individual under this section..." (emphasis added).

The National Taxpayer Advocate intended to recommend in her 2006 Annual Report to Congress that Congress amend IRC § 6015(f) to provide such jurisdiction, but did not do so because a bill, H.R. 6111, which became TRHCA, had passed both houses of Congress and was signed by the President on Dec. 6, 2006. National Taxpayer Advocate 2006 Annual Report to Congress 535. In *Billings v. Comm'r*, T.C. Memo. 2007-234 the Tax Court held that it had jurisdiction to consider the case it had previously dismissed for lack of jurisdiction in *Billings v. Comm'r*, 127 T.C. 7 (2006).

<sup>20</sup> 130 T.C. 115 (2008).

<sup>21</sup> The Tax Court's decision in *Porter I* was in response to the IRS's motion *in limine* (i.e., as a preliminary matter) to preclude the taxpayer from introducing evidence not contained in the administrative record.

<sup>22</sup> *Neal v. Comm'r*, T.C. Memo. 2005-201, *aff'd sub nom. Comm'r v. Neal*, 557 F.3d 1262 (11th Cir. 2009).

<sup>23</sup> Notice CC-2009-021 (June 30, 2009).

<sup>24</sup> See Opening Brief for Respondent at 15, *Wilson v. Comm'r*, T.C. Memo. 2010-134 (No. 23882-04), 2005 WL 6503242; *Haigh v. Comm'r*, T.C. Memo. 2009-140, slip op. at 14 n.25; *Beatty v. Comm'r*, T.C. Memo. 2007-167, slip op. at 19 n.3. The government makes the same argument to the appellate court in *Wilson*, *supra*. See Brief for the Appellant at 55-59, *Wilson v. Comm'r*, No. 10-72754 (9th Cir. Jan. 19, 2011). IRC § 6330 provides for notice and opportunity for a collection due process hearing before the IRS may levy upon the property of any person. At the hearing, the person may raise any relevant issue relating to the unpaid tax or proposed levy, including spousal defenses, challenges to the appropriateness of the collection action, and offers of collection alternatives. IRC § 6330(c)(2)(A). The person may challenge the existence or amount of the underlying tax liability for any period only if the person did not receive a notice of deficiency or did not otherwise have an opportunity to dispute the liability. IRC § 6330(c)(2)(B). Once the IRS issues a notice of determination, the person may petition the Tax Court. IRC § 6330(d)(1). As contemplated in the legislative history of IRC § 6330, see H.R. Conf. Rept. No. 105-599 at 266 (1998), if the validity of the underlying tax liability is at issue, the Tax Court standard of review for that issue is *de novo*. Other issues are reviewed for an abuse of discretion, described *infra*. *Sego v. Comm'r*, 114 T.C. 604, 610 (2000).

review in collection due process cases under IRC § 6330, where the underlying liability is not at issue, is confined to the administrative record.<sup>25</sup> The Tax Court continues to reject the IRS's position that review under IRC § 6015(f) is limited to the administrative record and rejects the analogy to proceedings under IRC § 6330.<sup>26</sup>

### Standard of Review

"The *scope* of judicial review refers...to the *evidence* the reviewing court will examine in reviewing an agency decision. The *standard* of judicial review refers to *how* the reviewing court will examine that evidence."<sup>27</sup> Under a *de novo* standard of review, the court considers the facts of the case anew and determines whether it is inequitable to hold the requesting spouse liable for the unpaid tax or deficiency. Under an abuse of discretion standard, the court reviews the IRS's denial of relief and overturns that determination only where it is shown to be arbitrary, capricious, or without sound basis in fact, and the requesting spouse bears the burden of proving that the Commissioner abused his discretion in denying relief.<sup>28</sup>

In *Porter v. Commissioner (Porter II)*, the Tax Court considered the language of IRC § 6015, which provides, under subsections (b) and (c), that the taxpayer "elects" relief, and if she or he meets the statutory requirements, "shall" be relieved of liability for the deficiency. Subsection (f), by contrast, provides that the IRS "may," pursuant to procedures it prescribes, relieve an individual of liability for any unpaid tax or deficiency stemming from a joint return when, in consideration of all the facts and circumstances, it would be inequitable to hold the individual liable. The court noted that it had previously reviewed IRC § 6015(f) cases for an abuse of discretion. However, the court decided, "Given Congress's confirmation of our jurisdiction [in stand-alone IRC § 6015(f) cases], reconsideration of the standard of review in section 6015(f) cases is warranted."<sup>29</sup> The Tax Court held that from then on it would review IRS denials of relief under IRC § 6015(f) using a *de novo* standard, rather than the abuse of discretion standard of review it had previously used. The Tax Court noted that it had always reviewed claims for relief under IRC § 6015(b) and (c) *de*

<sup>25</sup> *Robinette v. Comm'r*, 439 F.3d 455 (8th Cir. 2006), *rev'g* 123 T.C. 85 (2004); *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006), *affg* 125 T.C. 301 (2005).

<sup>26</sup> See, e.g., *Torrisi v. Comm'r*, T.C. Memo. 2011-235, slip op. at 17 n.15 (acknowledging the IRS's disagreement with *Porter II* and the court's use of *de novo* standard and scope of review in equitable innocent spouse relief cases, but declining to revisit the issue). The Tax Court generally reviews IRC § 6330 cases *de novo*, except in cases appealable to courts of appeal that have held otherwise. Pursuant to the rule in *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd* 445 F.2d 985 (10th Cir. 1971), the Tax Court will defer to a Court of Appeals decision which is squarely on point where appeal from the Tax Court decision lies to that Court of Appeal. See *Olson v. Comm'r*, T.C. Memo. 2009-294, slip op. at 3-4; *Bruen v. Comm'r*, T.C. Memo. 2009-249, slip op. at 5 ("The CDP [collection due process] petitioner's agency-level remedies are described at some length in section 6330(a), (b), and (c), and section 6330(d)(2) provides that the CDP petitioner must first 'exhaust [ ] all administrative remedies' before coming to court; but section 6015 makes no explicit provision of agency-level remedies for innocent spouse relief and says nothing about exhausting them. The agency's CDP action is repeatedly characterized in section 6330 as a 'hearing,' but there is no agency hearing explicitly provided for the innocent spouse in section 6015. The taxpayer's CDP submission to the Tax Court under section 6330(d) is called an 'appeal' and is not referred to as a 'petition' anywhere in the statute, while section 6015(e) provides that the innocent spouse files a 'petition' that is nowhere called an 'appeal.' The Tax Court 'determine[s]' innocent spouse relief, sec. 6015(e)(1)(A), but simply has 'jurisdiction' over the agency's CDP determination, sec. 6330(d)(1).") (footnote ref. omitted).

<sup>27</sup> *Franklin Sav. Association v. Office of Thrift Supervision*, 934 F.2d 1127, 1136 (10th Cir.1991) (emphasis added).

<sup>28</sup> *Jonson v. Comm'r*, 118 T.C. 106, 125 (2002), *aff'd* 353 F.3d 1181 (10th Cir. 2003).

<sup>29</sup> 132 T.C. 203, 208 (2009); *Porter II* is a continuation of the same case that produced the 2008 holding (*Porter I*, discussed above) that Tax Court review of denials of relief under IRC § 6015(f) is not limited to the administrative record.

*novo*, and in view of the statutory direction that the Tax Court determine the appropriate relief available under subsections (b), (c), and (f), there was no longer any reason to apply a different standard of review under subsection (f) than under subsections (b) and (c).

## REASONS FOR CHANGE

The IRS position is that in all section 6015(f) cases, the proper standard of review is abuse of discretion and the scope of the Tax Court's review is limited to issues and evidence presented before Appeals or Examination. IRS attorneys are instructed to raise the scope and standard of review arguments whenever appropriate, noting the IRS's disagreement with the holding in the *Porter* opinions.<sup>30</sup> The Tax Court continues to follow its own precedent, employing the *de novo* standard and scope of review. One case with the issues of the proper scope and standard of review is pending on appeal.<sup>31</sup> The resulting uncertainty is a burden on taxpayers and consumes administrative and judicial resources. Moreover, the IRS's position would create particular difficulty for taxpayers who are victims of domestic violence or abuse. The recent *Stephenson* case is a good example of this dynamic.<sup>32</sup>

The Tax Court's finding that Mrs. Stephenson was physically and verbally abused by her husband was largely based on evidence produced at trial because the issue of abuse was not fully developed administratively.<sup>33</sup> The court relied on Mrs. Stephenson's testimony, which fleshed out the details of her abuse, and the corroborating testimony from a third-party witness. If the Tax Court had confined itself to the administrative record, it might not have found Mrs. Stephenson had been abused, which might have resulted in denying her relief.

Because victims of abuse may be more comfortable providing details of their abuse to a neutral third party — the judge — during a trial, rather than to the IRS during the administrative process, and for the other reasons given by the Tax Court, the National Taxpayer Advocate agrees that *de novo* review, not confined to the administrative record, is appropriate.

## EXPLANATION OF RECOMMENDATION

Amending IRC § 6015 to specify that the Tax Court scope and standard of review of IRC § 6015(f) cases is *de novo* would clarify that the Tax Court's review of denials of relief under IRC § 6015(f) is not limited to the administrative record, and the Tax Court reviews IRC § 6015(f) cases anew, without deference to the IRS's determination. This clarification would be consistent with Congress' intent in amending IRC § 6015(e) to specify that the Tax Court has jurisdiction in stand-alone innocent spouse cases, would codify the Tax Court's interpretation of the statute, and would avert a potential conflict among the Courts of Appeals.

<sup>30</sup> Notice CC-2009-021 (June 30, 2009).

<sup>31</sup> *Wilson v. Comm'r*, T.C. Memo. 2010-134, *appeal docketed*, No.10-72754 (9th Cir. Sept. 10, 2010).

<sup>32</sup> *Stephenson v. Comm'r*, T.C. Memo. 2011-16.

<sup>33</sup> See Most Serious Problem: *The IRS Does Not Sufficiently Recognize and Address Domestic Violence and Abuse and its Effects on Tax Administration*, *supra* (describing the need for better training in this area and the IRS's resistance to eliciting information about abuse).

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## Amend IRC § 6343(a) to Permit the IRS to Release Levies on Business Taxpayers that Impose Economic Hardship

### PROBLEM

Longstanding IRS regulations under Internal Revenue Code Section 6343(a) relieve individuals, but not businesses, from levies on the grounds of economic hardship.<sup>1</sup> In one area of collections activity, the IRS and Department of Treasury have expressly declined to take into account business economic hardship, citing concern that the government might thereby be forgoing the collection of taxes to support a nonviable business.<sup>2</sup> Thus, the IRS will not release levies when a business experiences an economic hardship, leading the IRS to use levies in lieu of collection alternatives.

Since the recession of 2008,<sup>3</sup> the IRS has increased its use of levies against businesses. In fiscal year (FY) 2011, the IRS collected \$702 million from its Business Master File (BMF) levies, an increase of 20 percent over FY 2008.<sup>4</sup> While the IRS Collection Field function (CFf) issued 822,757 levies, an increase of 120 percent from FY 2008,<sup>5</sup> the IRS accepted few collection alternatives. The IRS granted only 850 BMF offers in compromise (OICs) and 105,786 BMF installment agreements (IAs) in FY 2011.<sup>6</sup> Unlike collection alternatives, IRS levies may immediately force business liquidations, which may cause economic hardship to the business owners, their customers, and their employees, some of whom may be forced to seek public assistance. Moreover, in determining whether to levy against a business taxpayer's property, the IRS does not consider the working capital needs of a business to maintain operations and avoid liquidation.<sup>7</sup>

According to the regulations, the IRS is required to release levies against individual taxpayers, including sole proprietorships, if the levy will cause the individual an economic hardship (*i.e.*, the individual is unable to meet basic living expenses).<sup>8</sup> Further, the regulations provide that the IRS can enter into an effective tax administration OIC with an individual where the IRS could collect the liability in full but collection would create an economic hardship.<sup>9</sup> The IRS also may forgo collection of an individual taxpayer's account and place

<sup>1</sup> IRC § 6343(a)(1)(D); Treas. Reg. § 301.6343-1(b)(4) (eff. Dec. 30, 1994).

<sup>2</sup> Compromise of Tax Liabilities, 67 Fed. Reg. 48,025, 48,026 (July 23, 2002) (preamble).

<sup>3</sup> See CNN Money, *It's official: Recession since Dec. '07* (Dec. 1, 2008), <http://money.cnn.com/2008/12/01/news/economy/recession/index.htm>.

<sup>4</sup> IRS, Collection Activity Report NO-5000-23, *Collection Workload Indicators* (Oct. 2011).

<sup>5</sup> *Id.* The IRS collected \$585 million from its Business Master File (BMF) levies in FY 2008. The IRS Collection Field function (CFf) issued 374,028 levies in FY 2008. The CFf primarily collects from small businesses and self-employed individuals. The IRS does not specifically track or have a code in its integrated data retrieval system (IDRS) to show that a BMF levy has been made. The IRS classified 694,036 BMF taxpayers in taxpayer delinquent account (TDA) status (active collection inventory) for FY 2011. IRS, Collection Activity Report NO-5000-2, *TDA Cumulative Report* (Oct. 2011).

<sup>6</sup> IRS CDW, Business Master File (BMF) Transaction History Table, extract cycles between 201040-201139 for TC 971, Action Code (AC) 32 (fully accepted OIC). IRS, Collection Activity Report NO-5000-6, *Installment Agreement Report* (Oct. 2011).

<sup>7</sup> The IRS generally takes funds held by third parties (e.g., bank deposits) first. Internal Revenue Manual (IRM) 5.11.1.1.2(2), Notice of Levy vs. Seizure (Jan. 19, 1999). See also IRM 5.11.1.2.4(3) (Dec. 11, 2009) (discussing whether levy is appropriate).

<sup>8</sup> IRC § 6343(a)(1)(D); Treas. Reg. § 301.6343-1(b)(4).

<sup>9</sup> Treas. Reg. § 301.7122-1(b)(3), providing that economic hardship is defined by Treas. Reg. § 301.6343-1(b)(4); IRM 5.8.11.2.1 (Sept. 23, 2008).

it into currently not collectible (CNC) status if collection would create an economic hardship.<sup>10</sup> Under longstanding regulations, however, the IRS and Treasury have determined not to consider economic hardship or effective tax administration when applying collection alternatives or taking levy action against businesses.

### EXAMPLE

A business with 50 employees builds prefabricated homes for sale primarily in and around Las Vegas, Nevada. Due to a sudden economic downturn in that region, particularly in the housing market, the taxpayer falls behind on one quarter of its payroll taxes and owes \$30,000. The firm also has difficulty paying some of its suppliers, and several units it manufactured have not shipped due to its customers' financial difficulties. The taxpayer responds by freezing salaries, eliminating overtime, laying off employees, and discounting the units in its inventory for quick sale. Further, the taxpayer negotiates promissory notes payable to its suppliers to maintain its supply of raw materials until it can pay the notes when business volume increases. Two quarters later, a revenue officer (RO) contacts the taxpayer and requests full payment of \$30,000, plus interest and penalties. The business has consistently filed tax returns over its history and all of its deposits are current since the delinquent quarter. However, the taxpayer does not qualify for an installment agreement to full pay the delinquent quarter in 60 months because the taxpayer is barely earning enough to pay its operating expenses, purchase raw materials, make payroll, and pay its current tax obligations. The RO evaluates the taxpayer's assets, determines there is sufficient equity in assets, and decides that levying on the taxpayer's bank account, with a balance of \$45,000, would adequately pay the debt. However, levying will cause an economic hardship because it will force the taxpayer to stop paying either its operating expenses or payroll tax deposits.

The RO is not permitted to take into account the business's working capital needs or the economic hardship a levy would create for the business and its employees and customers. When the RO issues the levy, it causes significant business disruption to the taxpayer and results in two more employees being laid off.

### RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6343(a)(1)(D) to:

- Permit the IRS, in its discretion, to release a levy against the taxpayer's property or rights to property if the IRS determines that the satisfaction of the levy is creating an economic hardship due to the financial condition of the taxpayer's business; and
- Require the IRS, in making the determination to release a levy against a business on economic hardship grounds, to consider the economic viability of the business, the

<sup>10</sup> IRM 5.16.1.1 (Apr. 29, 2011). IRM 5.15.1.1(6) (Oct. 2, 2009) refers employees to Treas. Reg. § 301.6343-1(b)(4) in analyzing a taxpayer's financial condition.

nature and extent of the hardship (including whether the taxpayer exercised ordinary business care and prudence), and the potential harm to individuals if the business is liquidated, as well as whether the taxes could be collected from a responsible person under an IRC § 6672 Trust Fund Recovery Penalty (TFRP) assessment.<sup>11</sup>

## PRESENT LAW

After the IRS gives notice and demands payment of a tax liability, provides notice of the taxpayer's right to a Collection Due Process hearing, and gives the taxpayer at least 30 days notice before levying, the IRS can generally collect any tax by levy upon all of the taxpayer's property and rights to property.<sup>12</sup> The Taxpayer Bill of Rights I (TBOR I), enacted in 1988, requires that the IRS release any levy upon a taxpayer's property or rights to property if the IRS determines the levy is creating an economic hardship due to the financial condition of the taxpayer.<sup>13</sup>

Congress gave the Secretary of the Treasury a specific grant to prescribe regulations implementing levy release.<sup>14</sup> The IRS regulations regarding levy release for economic hardship state:

The levy is creating an economic hardship due to the financial condition of an individual taxpayer. This condition applies if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses. The determination of a reasonable amount for basic living expenses will be made by the director and will vary according to the unique circumstances of the individual taxpayer. Unique circumstances, however, do not include the maintenance of an affluent or luxurious standard of living.<sup>15</sup>

In its procedures, the IRS reasons, "Because economic hardship is defined as the inability to meet reasonable basic living expenses, it applies only to individuals (including sole proprietorship entities). Compromise on economic hardship grounds is not available to corporations, partnerships, or other non-individual entities."<sup>16</sup>

<sup>11</sup> IRC § 6672 provides that any person required to collect, truthfully account for, and pay over any tax imposed under the Code who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall be liable for a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. The penalty is also known as the Trust Fund Recovery Penalty (TFRP).

<sup>12</sup> IRC § 6331(a),(d). IRC § 6330 provides that the IRS may not issue a levy before providing a Collection Due Process (CDP) hearing notice, nor during any requested hearing, unless the collection of the tax is in jeopardy, or the levy is upon a taxpayer's state tax refund, is a federal contractor levy, or is a disqualified employment tax levy. Any levy to collect employment taxes is a disqualified employment tax levy if the taxpayer requested a CDP hearing with respect to employment taxes arising in the most recent two-year period before the beginning of the taxable period with respect to which the levy is served. IRC § 6330(h)(1).

<sup>13</sup> This section of Taxpayer Bill of Rights I was enacted as part of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, § 6236(f), 102 Stat. 3740 (codified as IRC § 6343(a)).

<sup>14</sup> IRC § 6343(a) provides for "Regulations prescribed by the Secretary."

<sup>15</sup> Treas. Reg. § 301.6343-1(b)(4)(i).

<sup>16</sup> IRM 5.8.11.2.1(2) (Sept. 23, 2008) (emphasis in original).

In developing the regulations for effective tax administration offers in compromise (ETA OICs), the IRS and Treasury considered taking business economic hardship into account but did not develop a standard for doing so.<sup>17</sup> They ultimately concluded that granting ETA OICs on the grounds of business economic hardship did not necessarily promote effective tax administration because permitting compromise where there is no doubt as to collectibility might raise the issue of “whether the government should be forgoing collection of taxes to support a nonviable business.”<sup>18</sup>

## REASONS FOR CHANGE

The IRS should generally reserve levy actions for situations where a taxpayer is unwilling to cooperate or comply.<sup>19</sup> If the IRS releases levies for business economic hardship, the IRS and taxpayers may work toward collection alternatives giving businesses a second chance when facing economic hardship. Treasury regulations and IRS procedures are restrictive in allowing businesses access to collection alternatives to settle their tax debts. Further, IRS enforcement actions may lead to noncompliance if they are so harsh as to force the taxpayer into the cash economy.<sup>20</sup>

Currently, the use of flexible payment alternatives by the IRS to resolve business-related tax debts is negligible. At the end of FY 2011, the IRS’s inventories of active balance due and active collection cases held 5.3 million BMF taxpayers.<sup>21</sup> Yet, in FY 2011, the IRS accepted only 850 BMF OICs, which is less than one-tenth of one percent of its active inventory, and 105,786 BMF IAs, which is two percent of its active inventory.<sup>22</sup> Greater flexibility in considering collection and payment alternatives, as opposed to enforced collection, may enable cooperative businesses to remain in compliance with current payment requirements.

Before seizing business assets, the IRS considers alternative methods of collection, including bank or wage levies, IAs, or OICs, but will not use a collection alternative that places greater collection risk on the government.<sup>23</sup> The IRS’s risk analysis does not consider market conditions, supplier or customer problems, or other factors causing economic hard-

<sup>17</sup> Compromise of Tax Liabilities, 67 Fed. Reg. 48,025, 48,026 (July 23, 2002) (preamble).

<sup>18</sup> Treas. Reg. § 301.7122-1(b)(3); Compromise of Tax Liabilities, 67 Fed. Reg. 48,025, 48,026 (July 23, 2002) (preamble). The IRS and Treasury further reasoned that IRS experience has shown that the doubt as to collectibility standard for evaluating offers may permit the resolution of cases involving businesses. In addition, they reasoned if compromise was unavailable on collectibility grounds, compelling public policy or equity considerations under the effective tax administration standard may provide sufficient grounds to compromise.

<sup>19</sup> See Most Serious Problem: *The IRS Does Not Emphasize the Importance of Personal Taxpayer Contact as an Effective Tax Collection Tool*, *supra*.

<sup>20</sup> National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75-77 (*Researching the Causes of Noncompliance: an Overview of Upcoming Studies*). Small businesses that receive income not subject to information reporting in a cash economy may be responsible for the largest portion of the tax gap. IRS, Tax Gap Map for Year 2001 (Feb. 2007).

<sup>21</sup> IRS, Compliance Data Warehouse (CDW), BMF Status History Table and Transaction History Table, extract cycles between 201040-201139 for Status Code 21 (balance due), Status Code 22 (Automated Collection System (ACS)), Status Code 26 (CFf), Status Code 58 (final balance due notice), and Status Code 71 (offer in compromise (OIC) pending), including unreversed Transaction Codes (TCs) 480 and 780 (OIC pending or in suspense).

<sup>22</sup> IRS CDW, Business Master File (BMF) Transaction History Table, extract cycles between 201040-201139 for TC 971, Action Code (AC) 32 (fully accepted OIC). IRS, Collection Activity Report NO-5000-6, *Installment Agreement Report* (Oct. 2011).

<sup>23</sup> IRM 5.10.1.3.2 (Oct. 13, 2005).

ship when weighing seizure of a business's assets such as raw materials or equipment. For example, revenue officers compare the business's prior year gross receipts against current receipts to project future income.<sup>24</sup> This comparison does not necessarily reflect future market or economic conditions. Further, the IRS fails to consider the working capital needs of a business to maintain operations and avoid liquidation.<sup>25</sup>

Guided by Treasury regulations, the IRS's procedural guidance and techniques to evaluate payment alternatives for businesses focus on the business's ability to liquidate its productive assets to pay existing tax debts, rather than the impairment of a business's cash flow, to determine if it can satisfy its debts while remaining viable.<sup>26</sup> IRS collection procedures do not call for consideration of factors such as the years the entity has been in business, the business's long-term compliance history, or the nature of the delinquency problem in the analysis of enforced collection action. A better analysis would also consider whether the tax problems are related to abrupt, temporary changes in market conditions (in terms of the nation, geographic region, and specific industry or sector), supplier problems, credit supply, or whether the taxpayer has a history of poor business decisions.

The IRS should not be an unwilling partner in a business venture,<sup>27</sup> but also should not cause the failure of a viable business that is exercising ordinary business care and prudence. In the context of whether a business taxpayer exercised ordinary business care and prudence in failing to pay employment taxes, the Tax Court weighs several factors including the taxpayer's (1) favoring other creditors over the government, (2) past history of deposit noncompliance, (3) financial decisions, and (4) willingness to decrease expenses and personnel.<sup>28</sup> Although the IRS considers some of these factors in its collection analysis, the IRS does not consider whether the taxpayer exercised ordinary business care and prudence in its decisions when evaluating collection alternatives or whether to take levy action. The IRS and Treasury established regulations interpreting economic hardship during economic prosperity. Given current economic conditions, Congress should provide additional relief by permitting the government to forgo the collection of tax by levy after the IRS makes certain determinations about how a levy will affect a business.

<sup>24</sup> IRM 5.15.1.14(2) (Oct. 2, 2009).

<sup>25</sup> The IRS generally takes funds held by third parties (e.g., bank deposits) first. IRM 5.11.1.1.2(2), Notice of Levy vs. Seizure (Jan. 19, 1999). See also IRM 5.11.1.2.4(3) (Dec. 11, 2009), discussing whether levy is appropriate.

<sup>26</sup> IRM 5.14.2.1 (Mar. 11, 2011). IRM 5.8.5.4 (Oct. 22, 2010). IRM 5.15.1.12, *Business Entities* (Oct. 2, 2009) provides that using the income statement, a taxpayer or revenue officer can quickly figure cash flow, and how the business is doing, but the procedure does not explain what to do if cash flow has decreased or is impaired. IRM 5.15.1.14(2) (Oct. 2, 2009) provides that comparing a business's prior year's gross receipts versus current year's gross receipts gives revenue officers a "good idea" of cash flow, but does not explain how impairment of cash flow should be handled. IRM 5.15.1.34(3), *Cash Flow Analysis* (May 9, 2008) provides that cash flow is the best measure of a company's profits, but the IRM section does not explain why or how this should be adjusted if a business is suffering an economic crisis.

<sup>27</sup> See, e.g., *Brewery, Inc. v. U.S.*, 33 F.3d 589, 593 (6th Cir. 1994) holding that a business's sound judgment to divert trust fund taxes to pay wages and suppliers was not reasonable cause for failing to pay taxes but rather constituted willful neglect. The court further observed that failure to remit trust fund taxes cannot properly be excused on the grounds that the business has used the funds to pay other creditors, as the government would thereby be made an unwilling partner in a floundering concern.

<sup>28</sup> *Custom Stairs & Trim, Ltd. v. Comm'r*, T.C. Memo. 2011-155, slip op. at 18-19.

## EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends that IRC § 6343 be amended to authorize the IRS to release a levy if it determines that the levy is creating an economic hardship due to the financial condition of the taxpayer's viable trade or business. The legislation should require the IRS, in determining whether to release a levy for economic hardship, to consider all the facts and circumstances of the taxpayer's financial situation, including the business's viability and its expenditures in light of its income. By making the release of the levy discretionary for businesses but retaining the mandatory release for individuals experiencing economic hardship, the recommendation acknowledges the government's concern to not become an "unwilling partner" in a business venture.

### **The IRS must first determine the viability of a business.**

In deciding whether to release a levy, the IRS must determine whether the business is a going concern that is actively engaged in business with the expectation of doing so indefinitely. The business should be able to demonstrate its projected continued operation for a reasonable period and should provide evidence of positive cash flow (*i.e.*, cash receipts sufficient to cover cash expenditures for a specific period), or a plan to achieve the same.<sup>29</sup> Earning income sufficient to fund minimum working capital, pay current business operating expenses, and pay current taxes should support a finding that the business is viable. Further, a taxpayer's reasonable plan to overcome current income shortfalls by adjusting expenses or eliminating nonessential expenses, or by implementing new activities that will generate additional income after expenses, should weigh in favor of business viability.

### **After determining whether a business is viable, the IRS should employ several factors to determine business economic hardship.**

A finding of business economic hardship should include a review of the change in a business's financial condition such as declining sales, the death or disability of a key officer or employee, frozen credit lines, a reduction in working capital, difficulty meeting expenses or making loan payments, as well as whether the taxpayer exercised ordinary business care and prudence in its decisions.<sup>30</sup> The IRS should require the taxpayer to demonstrate that it is experiencing an economic hardship, identify its nature, and provide evidence to confirm it exists.

<sup>29</sup> See, *e.g.*, Small Business Administration (SBA), Office of the Inspector General, Report No. ROM 11-03, *America's Recovery Capital (ARC) Loans Were Not Originated and Closed in Accordance with SBA's Policies and Procedures* 5 (Mar. 2, 2011), which describes the standards used in the ARC Loan Program. The SBA created the ARC Loan Program pursuant to the American Recovery and Reinvestment Act of 2009 to provide deferred-payment, interest-free loans of up to \$35,000 to "viable small businesses" experiencing "immediate financial hardship." The SBA designed the program, which expired on September 30, 2010, to help businesses make principal and interest payments on qualifying small business loans. Under the ARC loan program, the SBA required businesses to demonstrate continued operation for a reasonable period by providing quarterly cash flow projections for up to two years.

<sup>30</sup> SBA Office of the Inspector General, Report No. ROM 11-03, *America's Recovery Capital (ARC) Loans Were Not Originated and Closed in Accordance with SBA's Policies and Procedures* 2 (Mar. 2, 2011). Immediate financial hardship is demonstrated by a change in the financial condition of a small business such as a 20 percent or more decline in revenue over the preceding 12 months, a 20 percent or more increase in expenses over the preceding 12 months, or a 20 percent or more reduction in working capital, and so forth.

As with individuals, the maintenance of the business owner's affluent or luxurious standard of living should weigh against the IRS determining economic hardship.<sup>31</sup> A history of past compliance should weigh in favor of a determination of economic hardship. Business revenue loss due to a permanent impairment on a business without a corresponding reduction in employees, bonuses, salaries, or other expenses should weigh against a finding of economic hardship, unless the revenue loss is due to a problem such as a natural disaster.

Unlike an individual in economic hardship, a business does not have basic living expenses *per se*, but will have business-related expenses that are necessary for continued operation. Additionally, most businesses have related parties (employees, customers, contractors, owners) who could suffer an economic hardship if the levy is satisfied, particularly if the IRS enforcement action will likely lead to the failure of the business. As the number of affected persons increases, a determination of economic hardship might become more compelling. The IRS should also evaluate any other factor or special circumstance raised by the taxpayer that is causing hardship before the IRS determines business economic hardship. Further, the IRS should consider all of the factors identified to determine business economic hardship together, and no single factor should be dispositive.

Permitting levy releases for business economic hardship will necessarily change the collection methods and alternatives the IRS uses for businesses. The IRS will likely need to revise the regulations for ETA OICs, and the IRS will likely modify its procedures for levies, IAs, OICs, and CNC status. This recommendation may result in more business economic hardship determinations by the IRS in economic downturns, and fewer in times of prosperity.<sup>32</sup>

<sup>31</sup> Treas. Reg. § 301.6343-1(b)(4)(i) (quoted above).

<sup>32</sup> The National Taxpayer Advocate notes that if the IRS modified its policies for collection enforcement and collection alternatives to resolve more cases without enforced collection, it would reduce the need for levy releases due to economic hardship. National Taxpayer Advocate 2010 Annual Report to Congress 85-97 (Most Serious Problem: *IRS Collection Policies and Procedures Fail to Adequately Protect Taxpayers Suffering an Economic Hardship*), 302-310 (Status Update: *The IRS Has Been Slow to Address the Adverse Impact of its Lien-Filing Policies on Taxpayers and Future Tax Compliance*), vol. 2 39-70 (*An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue, Improve Taxpayer Service, and Further the IRS Mission*); National Taxpayer Advocate 2009 Annual Report to Congress 196-212 (Most Serious Problem: *The Steady Decline of the IRS Offer in Compromise Program is Leading to Lost Opportunities for Taxpayers and the IRS Alike*); National Taxpayer Advocate 2008 Annual Report to Congress 54-78 (Most Serious Problem: *Employment Taxes*); National Taxpayer Advocate 2007 Annual Report to Congress 395-410 (Most Serious Problem: *Assessment and Processing of the Trust Fund Recovery Penalty (TFRP)*); National Taxpayer Advocate 2006 Annual Report to Congress 62-82 (Most Serious Problem: *Early Intervention in IRS Collection Cases*); National Taxpayer Advocate 2004 Annual Report to Congress 226-245 (Most Serious Problem: *IRS Collection Strategy*).

LR  
#6**Amend the Erroneous Refund Penalty to Permit Relief in Case of  
Reasonable Cause for Claim to Refundable Credits****PROBLEM**

Even if they do not owe tax, businesses and individuals may claim a refund due to a special tax break such as one designed to support home ownership or health care.<sup>1</sup> Many special tax breaks are refundable credits commonly known as “negative taxes” targeted at small business, low and middle-income taxpayers, who paradoxically may be challenged by the complexity of the tax law.<sup>2</sup> Misunderstanding the rules may leave these taxpayers charged with a penalty of a fifth of their denied claim, even if they started with no taxable income from which to pay.<sup>3</sup> To a taxpayer who has attempted to understand and comply with the tax law, a penalty for merely asking for a refund that the IRS denies adds insult to injury.

**EXAMPLE**

The Code allows a First-Time Homebuyer Credit (FTHBC) in certain cases where the buyer enters into a written binding contract before May 1, 2010, and buys the home before October 1, 2010.<sup>4</sup> Taxpayer X responded to an advertisement from a real estate agent describing the FTHBC as a new government program that would help make the dream of home ownership a reality. In April of 2010, X found a home but chose not to proceed with the purchase due to various circumstances. That summer, the agent advised X that the deadline for the FTHBC had been extended, and pushed X to close on the home by September. The agent said closing by September would be soon enough, explaining in a letter that X had a “meeting of minds” with the seller as of April that would qualify X for the FTHBC. On a 2010 federal tax return properly showing no tax due (beyond that covered by withholding), X, a high school graduate with no significant tax knowledge or experience, claims the \$8,000 credit. The IRS examines the return and determines that a “meeting of minds” does not meet the requirement of entering into a binding contract before May 1, 2010. Denying the refund claim, the IRS assesses X a \$1,600 penalty (to be paid with no opportunity for a hearing in the United States Tax Court) despite X’s reliance on the real estate agent’s advice and letter, and despite X’s lack of education, knowledge, or experience with taxes.

<sup>1</sup> See Internal Revenue Code (IRC) §§ 36, 36B, 45R.

<sup>2</sup> On the characteristics of taxpayer segments, see *supra* Introduction to Diversity Issues: The IRS Should Do More to Accommodate Changing Taxpayer Demographics and sources cited therein.

<sup>3</sup> See IRC § 6676.

<sup>4</sup> IRC § 36.

## RECOMMENDATION

Amend the erroneous refund penalty under IRC § 6676 to permit relief from a penalty for erroneously claiming a refund pursuant to a refundable credit if the taxpayer acted with reasonable cause and in good faith.

## PRESENT LAW

Generally, an accuracy-related penalty adds 20 percent of an underpayment attributable to negligence, substantial understatement (*i.e.*, failing to show ten percent of the correct tax or \$5,000, whichever is more), or certain other factors to any tax otherwise owed.<sup>5</sup> The IRS will not impose the penalty if the taxpayer acted with reasonable cause and in good faith.<sup>6</sup> Among the facts and circumstances indicating reasonable cause and good faith are the taxpayer's experience, knowledge, and education, or reliance on professional advice.<sup>7</sup>

The accuracy-related penalty depends on underpayment, and according to the Department of the Treasury, disallowance of "a refund or credit claim does not result in an underpayment."<sup>8</sup> In 2007, the Treasury proposed a new penalty on erroneous refunds for this reason, stating that absent "a frivolous position evident on the face of the return, there is no accuracy-related penalty applicable to disallowance of a refund or credit claim."<sup>9</sup> At the same time, the Treasury proposal recommended relief in case of reasonable cause or reasonable basis: "A penalty would be imposed in the amount of up to 20 percent of a disallowed portion of a claim for refund or credit for which there is no reasonable basis for the claimed tax treatment or for which the taxpayer did not have reasonable cause."<sup>10</sup>

That year, Congress enacted an assessable penalty of 20 percent of an excessive claim for refund. It does not apply to claims for the earned income tax credit (EITC) or to claims having a reasonable basis.<sup>11</sup> Generally, reasonable basis means reliance on authorities such as rulings or legislative history.<sup>12</sup> As enacted, the provision does not allow relief for reasonable cause. The erroneous refund penalty does not apply where the accuracy-related penalty applies.<sup>13</sup>

<sup>5</sup> IRC § 6662.

<sup>6</sup> IRC § 6664(c).

<sup>7</sup> Treas. Reg. § 1.6664-4.

<sup>8</sup> Dep't of the Treas., *Gen. Explanations of the Admin's FY 2008 Rev. Proposals* (Feb. 2007) at 82. Nonetheless, the IRS characterizes an erroneously claimed refundable credit as an amount that contributes to an understatement. See Serv. Ctr. Adv. 2001-12-001 (dated Nov. 8, 1999, released Mar. 23, 2001); see also Program Manager Tech. Assistance 2011-03 (Aug. 27, 2010); Program Manager Tech. Assistance 2010-01 (Nov. 20, 2009). If, however, the IRS denies the claim before paying it, the IRS characterizes the denied claim as an amount assessed or collected for purposes of computing the accuracy-related penalty. An amount assessed or collected cannot be considered as underpaid. See Serv. Ctr. Adv. 1998-032 (dated Aug. 10, 1998, released Dec. 4, 1998).

<sup>9</sup> *Gen. Explanations of the Admin's FY 2008 Rev. Proposals* at 82.

<sup>10</sup> *Id.* Likewise, commentators observed that prior "to the 2007 Act, there was no applicable penalty imposed on a disallowed, nonfrivolous refund claim." Fisk & Lee, *Section 6676 Erroneous Claim for Refund or Credit Penalty*, 1 Tax Dev't J. 3 (2009).

<sup>11</sup> IRC § 6676 added by Pub. L. No. 110-28, § 8247, 121 Stat. 112, 204 (2007).

<sup>12</sup> Treas. Reg. § 1.6662-3(b)(3).

<sup>13</sup> IRC § 6676(d).

## REASONS FOR CHANGE

While enactment of the erroneous refund penalty closed the gap where the accuracy-related penalty did not apply, the 2007 legislation was overbroad. As enacted, the erroneous refund penalty may apply not only to claims without reasonable basis but also to inadvertent errors for which a confused taxpayer may have reasonable cause, especially in the case of special tax breaks designed as refundable credits.

Because the accuracy-related penalty applies only in case of underpayment, commentators have observed:

Prior to enactment of § 6676, there was strategic advantage for taxpayers to reserve tax positions for which there was less than a compelling level of authority to amended returns as there was no penalty for these positions taken in good faith, and, outside of a potential criminal sanction for filing false claims, there was little consequence for positions taken in bad faith.<sup>14</sup>

In other words, a refund may arise not only from a credit designed as refundable but from strategic placement of an argumentative tax claim on an amended return by a sophisticated taxpayer.<sup>15</sup> To the extent that the 2007 legislation contemplated sophisticated abuse, exception only in case of reasonable basis made sense. Nevertheless, the erroneous refund penalty now applies even to inadvertent errors by unsophisticated taxpayers.

By carving out EITC, the § 6676 legislation recognized this issue for the best-known of the refundable credits.<sup>16</sup> Since 2007, however, these credits have proliferated. In particular, the First-Time Homebuyer, Making Work Pay, health care, adoption, and American Opportunity tax credits were enacted or made refundable after creation of the erroneous refund penalty.<sup>17</sup> For business taxpayers, 2008 economic emergency legislation, in a provision expanded by the American Recovery and Reinvestment Act of 2009 as well as 2010 extender legislation, created an election to accelerate alternative minimum tax (AMT) or research credits in lieu of that year's bonus depreciation and made the amount refundable.<sup>18</sup> Because these significant refundable credits came into being after 2007, the erroneous refund penalty legislation could not have anticipated and provided exceptions for them.<sup>19</sup>

<sup>14</sup> 1 Tax Dev't J. at 7-8.

<sup>15</sup> On amended returns and sophisticated claims, see, e.g., *Eustace v. Comm'r*, T.C. Memo. 2001-66 (describing the use of amended returns to claim refunds of research credit), aff'd, 312 F.3d 905 (7th Cir. 2002); *Union Carbide v. Comm'r*, T.C. Memo. 2009-50 (describing multi-million dollar research credits).

<sup>16</sup> See, e.g., Daniel P. Gitterman, Lucy S. Gorham & Jessica L. Dorrance, *Expand the EITC for Single Workers and Couples Without Children*, Policy Brief Prepared for the Ctr. on Poverty, Work & Opportunity, Univ. of N.C. at Chapel Hill 1 (Jan. 2007) (calling EITC "the nation's largest anti-poverty program").

<sup>17</sup> IRC §§ 36, 36A, 36B, 36C, 25A; see also IRC § 45R(f) (relating to refundability of health care credit for small tax-exempt employer).

<sup>18</sup> IRC § 168(k)(4) as amended by Pub. L. Nos. 110-289, § 3081, 122 Stat. 2654, 2903 (2008), 111-5, Div. B, § 1201, 123 Stat. 115, 333 (2009), & 111-240, § 2022, 124 Stat. 2504, 2558 (2010).

<sup>19</sup> Historically, special tax breaks have taken the form of refundable credits at least since 1965 when an IRC § 34 refundable fuel tax credit was allowed to farmers and certain other taxpayers. See Pub. L. No. 89-44, § 809, 79 Stat. 136, 165. Part of the IRC § 24 child tax credit known as the additional child tax credit is refundable, as is an IRC § 35 health insurance credit for displaced workers enacted within the Trade Act of 2002, Pub. L. No. 107-210, § 201, 116 Stat. 933, 954. Technically, refunds of over-withholding are effectuated through refundable credits in IRC §§ 31 & 33.

## EXPLANATION OF RECOMMENDATION

Allowing a taxpayer to present reasonable cause for an error would be consistent with the purpose of refundable credits, which generally are economic incentives, designed to encourage certain behaviors, and structured as special tax breaks.<sup>20</sup> The proposed amendment to IRC § 6676 would be consistent with the 2007 legislation, which excepted the refundable credit best-known at the time (the EITC).<sup>21</sup>

Otherwise, the erroneous refund penalty could be unduly harsh to an extent not contemplated at enactment. One possibly unforeseen consequence is that a hapless taxpayer targeted for a special tax break could be charged by the IRS for payment of an erroneous refund penalty without recourse to the Tax Court.<sup>22</sup> By contrast, if the accuracy-related penalty applied, the taxpayer would have an opportunity to present reasonable cause to the IRS, and if necessary to contest the penalty in the Tax Court before paying it. This procedural opportunity arises because the accuracy-related penalty is classified as an addition to tax rather than an assessable penalty.<sup>23</sup>

<sup>20</sup> See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75 (Research Study: *Running Social Programs Through the Tax System*); National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 101 (Research Study: *Evaluate the Administration of Tax Expenditures*).

<sup>21</sup> As discussed above, the 2007 legislation allowed relief for reasonable basis, which the proposed reasonable cause relief would parallel procedurally. IRM 20.1.5.14.3 (July 1, 2008) states that rules on IRC § 6676 reasonable basis will be prescribed by regulation. Inasmuch as IRM 8.11.1.2 (Aug. 15, 2008) allows post-assessment penalty appeal, the recommended legislation would confirm a taxpayer's right to appeal a denial of reasonable cause relief.

<sup>22</sup> RC § 6671. IRM 8.11.1.2 (Aug. 15, 2008) allows post-assessment penalty appeal within the IRS.

<sup>23</sup> IRC § 6665.

LR  
#7**Authorize the IRS Office of Appeals to Rescind Notices of  
Determination Issued in Collection Due Process Cases****PROBLEM**

Before the IRS can seize a taxpayer's assets or after it has filed a Notice of Federal Tax Lien (NFTL) against the taxpayer, the Office of Appeals (Appeals) is generally required to hold a Collection Due Process (CDP) hearing for a taxpayer who requests a hearing and states grounds for the request.<sup>1</sup> Appeals holds informal CDP hearings face-to-face, by telephone, or through correspondence.<sup>2</sup> After a hearing, Appeals issues a notice of determination (NOD), giving the taxpayer 30 days to petition for Tax Court review.<sup>3</sup>

Appeals officers are not required to review or consider information submitted by the taxpayer after Appeals issues the notice.<sup>4</sup> In some cases, Appeals issues an NOD before the taxpayer has had an opportunity to present information, because the taxpayer is unavailable at the time of the hearing, or the Appeals officer has not received the information before issuing the determination. After the IRS issues the NOD, the taxpayer faces a tough choice: to either forego Tax Court review and work with IRS Collection, seek an audit reconsideration from IRS Examination, or petition the Tax Court for a return or remand of the case to Appeals for a supplemental hearing. The inability of Appeals to rescind the NOD and rehear issues in appropriate cases may deprive some taxpayers of meaningful hearings, create a delay in resolving a taxpayer's case, and unnecessarily use Tax Court and IRS resources.

**EXAMPLE ONE**

A taxpayer timely files his 2009 return, but cannot pay \$10,500 in tax reported on the return. The IRS files an NFTL against the taxpayer's property, reporting the taxpayer's liability plus penalties and interest, and issues Letter 3172, *Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320*. The taxpayer timely files Form 12153, *Request for Collection Due Process Hearing*, and requests a hearing to seek lien subordination so he can borrow from the equity in his home to pay for a medical procedure.

The settlement officer (SO) schedules a hearing by telephone. On the day of the hearing, the taxpayer's illness forces him to go to the hospital, and he does not make the call. The SO tries to call the taxpayer but is unsuccessful and issues an NOD sustaining the lien. The next week, the taxpayer contacts the SO, explaining that he missed the hearing because he was hospitalized and asking the SO to schedule a new hearing to discuss his subordination request. The SO explains that he cannot do that because once Appeals issues an NOD it

<sup>1</sup> See generally Internal Revenue Code (IRC) §§ 6320 & 6330.

<sup>2</sup> IRC §§ 6330(b)(1) & 6330(b)(3). Treas. Reg. § 301.6330-1(d)(2) Q & A-D6 & D7.

<sup>3</sup> IRC § 6330(d). Treas. Reg. § 301.6330-1(e)(3) Q & A-E8.

<sup>4</sup> Internal Revenue Manual (IRM) 8.22.2.2.4.12 (Oct. 30, 2007).

cannot be rescinded, even if there is new information to consider. The taxpayer petitions Tax Court for review of the determination, and the court remands the case to Appeals for consideration of new information.

### EXAMPLE TWO

A small business taxpayer misses its quarterly payroll tax deposits of roughly \$50,000 for the first quarter of 2010 because its business manager failed to pay the deposits before he embezzled money and disappeared. The company stays in business by obtaining a line of credit secured by its accounts receivable, but the debt service makes it difficult for the firm to pay the delinquent quarter unless it lays off some employees. The IRS issues Letter 1058, *Final Notice: Notice of Intent to Levy and Notice of Your Right to a Hearing*, to the taxpayer. The taxpayer requests a face-to-face hearing seeking an installment agreement.

The SO sends a letter requesting that the taxpayer submit Form 433-B, *Collection Information Statement for Businesses*, within 15 days. The taxpayer timely submits the form and the SO holds a hearing at which she and the taxpayer agree an offer in compromise is the best collection alternative. The SO gives the taxpayer 15 calendar days to submit Form 656, *Offer in Compromise*. The taxpayer sends the form in on time but the mail is misrouted and does not reach the SO for 30 days. Before the SO receives the Form 656, she issues the NOD sustaining the levy. The taxpayer asks the SO to reconsider her decision sustaining the levy in light of the offer request. The SO states that she would like to consider the offer but cannot because the NOD cannot be rescinded. The taxpayer petitions the Tax Court, which remands the case to Appeals to consider the offer.

### RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend Internal Revenue Code § 6330 to permit the IRS Office of Appeals, with the consent of the taxpayer, to rescind CDP NODs in cases where the taxpayer has raised a legitimate concern regarding the NOD within the 30-day period for petitioning the Tax Court, and before the taxpayer has requested Tax Court review.

### PRESENT LAW

The Code does not authorize Appeals to rescind CDP NODs. Appeals issues its NOD, setting forth its findings and decisions concerning the proposed levy or filed lien, at the conclusion of the CDP hearing. The NOD includes verification of whether the IRS met the requirements of applicable law and procedures, resolution of any relevant issues raised by the taxpayer, and a finding of whether the proposed collection action balances the need for the efficient collection of taxes and the taxpayer's legitimate concern that any collection action be no more intrusive than necessary.<sup>5</sup> Within 30 days of Appeals' determination,

<sup>5</sup> Treas. Reg. §§ 301.6320-1(e)(3) A-E8 & 301.6330-1(e)(3) A-E8(i).

the taxpayer is entitled to appeal the NOD to the Tax Court.<sup>6</sup> Taxpayers are entitled to only one CDP levy hearing and one CDP lien hearing per taxable period to which an unpaid tax relates.<sup>7</sup>

The CDP NOD is the jurisdictional equivalent of a notice of deficiency.<sup>8</sup> Each notice provides the final administrative determination by the IRS on a specific collection action or understatement of tax.<sup>9</sup> IRS Examination or Appeals generally sends a notice of deficiency to the taxpayer after the IRS determines that a taxpayer's return underreports an amount of income, estate, or gift tax, and the taxpayer disagrees with the adjustment after having an opportunity for a conference with Appeals.<sup>10</sup> Within 90 days (or 150 days for taxpayers with addresses outside the United States) of the date on the notice of deficiency, the taxpayer is entitled to petition the Tax Court for a redetermination of the deficiency.<sup>11</sup>

With respect to notices of deficiency, but with no reference to CDP NODs, IRC § 6212(d) provides that the IRS may, with the consent of the taxpayer, rescind any notice of deficiency mailed to the taxpayer. However, the IRS cannot rescind deficiency notices after the taxpayer petitions the Tax Court because the court has jurisdiction over the matter at that point.<sup>12</sup>

## REASONS FOR CHANGE

Under present law, the IRS may be constrained from affording some taxpayers the opportunity for a meaningful CDP hearing, delaying resolution and creating additional cases for Tax Court review. The Tax Court remands cases to Appeals when they are factually incomplete and need development, or Appeals abused its discretion.<sup>13</sup> The Tax Court remanded 10.4 percent of its CDP cases in FY 2010.<sup>14</sup> Appeals should be able to rescind CDP NODs when it determines that it did not consider or review information that could

<sup>6</sup> IRC §§ 6320(c) & 6330(d)(1).

<sup>7</sup> IRC §§ 6320(b)(2) & 6330(b)(2).

<sup>8</sup> *Offiler v. Comm'r*, 114 T.C. 492, 498 (2000).

<sup>9</sup> See, e.g., IRC § 6330(c)(2)(B) which provides that a taxpayer may raise the underlying tax liability in a CDP hearing, among other collection issues, if the taxpayer has not received a notice of deficiency or otherwise had an opportunity to dispute the liability. IRC § 6212(c) provides that after a taxpayer timely petitions the Tax Court for a redetermination of a deficiency, the IRS generally may not determine any additional deficiency with respect to the income, estate, or gift tax for the same tax period.

<sup>10</sup> IRC § 6212. Treas. Reg. §§ 601.103, 601.105(d)(iv), 601.106(b) & 601.106(d)(2)(ii).

<sup>11</sup> IRC § 6213(a).

<sup>12</sup> *Comm'r v. Shapiro*, 424 U.S. 614, 630 (1976).

<sup>13</sup> See *Wadleigh v. Comm'r*, 134 T.C. 280 (2010) (remand for clarification of the record); *Alessio Azari, Inc. v. Comm'r*, 136 T.C. No. 9 (2011) (remand for abuse of discretion).

<sup>14</sup> Appeals, ACDS, *Diagnostics and Balanced Appeals Measures Report System* (FY 2010). IRS Chief Counsel, Counsel Automated Tracking System, PPL3254 (FY 2010). TAS compared the number of cases remanded per the ACDS over the number of cases disposed by the Tax Court.

materially change the resolution in the taxpayer's determination.<sup>15</sup> Providing Appeals with the discretion to rescind an NOD with the taxpayer's consent will save taxpayer and IRS resources by allowing Appeals to correct for unavoidable or excusable procedural delays and missteps, while protecting the taxpayer's right to Tax Court review where differences are irreconcilable.

### EXPLANATION OF RECOMMENDATION

The recommendation permits the IRS to rescind NODs within 30 days of the date of the determination, and only before the taxpayer has petitioned the Tax Court. The recommendation authorizes Appeals to rescind an NOD when the taxpayer and Appeals agree to rescind.<sup>16</sup> The recommendation will give taxpayers the choice, in the 30-day period from the date of Appeals' determination, to either seek consideration of new information by Appeals, or proceed to the Tax Court to challenge the NOD.

<sup>15</sup> Notwithstanding the general rule prohibiting rescission of CDP Notices of Determination, Appeals has proposed the administrative practice of amending the NOD within the 30-day period to petition Tax Court if: the NOD is clearly in error; the taxpayer has not petitioned Tax Court; and the correction can be made within the 30-day period to petition Tax Court. Although this procedure obviates the problem in some cases, it would not assist taxpayers where more than 30 days would be needed to adequately evaluate the taxpayer's case, or where the taxpayer filed a petition unaware that Appeals was amending its determination. Moreover, this procedure may serve to confuse taxpayers and lead them to forego Tax Court review.

<sup>16</sup> Permitting Appeals to rescind NODs unilaterally would be ineffective, because once Appeals issues an NOD, the taxpayer has a right to proceed to Tax Court. It is unlikely the Tax Court would refuse to consider a timely filed petition on the ground that Appeals unilaterally rescinded a valid NOD.

LR #8

## Clarify that the Emergency Exception to the Anti-Deficiency Act Includes IRS Activities that Protect Taxpayer Life and Property

### PROBLEM

When the appropriation of funds for a federal agency for a fiscal year expires without a continuing resolution or new appropriation for the current fiscal year, the Anti-Deficiency Act generally prohibits the agency from incurring obligations to pay its employees.<sup>1</sup> During these periods of “lapsed appropriations,” the agency may only expend funds as necessary to bring about the orderly termination of its functions.<sup>2</sup> An agency is also prohibited from employing the personal services of its employees even without incurring obligations to pay them, but with an important exception: “for emergencies involving the safety of human life or the protection of property.”<sup>3</sup>

In 2011, the IRS developed two shutdown contingency plans in anticipation of lapses in appropriations, one during the filing season and one during the nonfiling season.<sup>4</sup> Both plans reflect the IRS and the Department of Treasury position that the emergency life and property exception applies to agency functions that are in essence public safety or police powers. The National Taxpayer Advocate believes the IRS’s shutdown contingency plan prevents it from assisting taxpayers even in emergencies involving the safety of human life or the protection of property. The National Taxpayer Advocate’s authority to issue Taxpayer Assistance Orders (TAOs) pursuant to Internal Revenue Code (IRC) § 7811 does not explicitly include the authority to incur obligations in advance of appropriations and thus may not compensate for the current inability to assist taxpayers.<sup>5</sup>

### EXAMPLE

A low income taxpayer who does not have access to a computer claims a refund on her timely filed paper tax return. She intends to use the money to pay past-due heating and electricity bills and purchase medical supplies to treat her diabetes. Because the appropriation of funds has expired, and the IRS concludes there is no reasonable connection between

<sup>1</sup> 31 U.S.C. § 1341(a). A continuing resolution is “An appropriation act that provides budget authority for federal agencies, specific activities, or both to continue in operation when Congress and the President have not completed action on the regular appropriation acts by the beginning of the fiscal year.” Government Accountability Office, GAO-05-734SP, *A Glossary of Terms Used in the Federal Budget Process* (2005), 35-36 available at <http://www.gao.gov/new.items/d05734sp.pdf>.

<sup>2</sup> *Applicability of the Antideficiency Act Upon A Lapse in Agency Appropriations*, 43 Op. Att’y Gen. 224 (1980).

<sup>3</sup> 31 U.S.C. § 1342.

<sup>4</sup> Filing season is the period January through April, when most taxpayers file their tax returns. IRS, *FY 2012 Shutdown Contingency Plan* (Rev. Nov. 16, 2011), available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited Dec. 21, 2011) contemplates a lapse in appropriations other than during filing season. IRS, *FY 2011 Shutdown Contingency Plan* (Rev. Apr. 7, 2011) available at [http://www.treasury.gov/connect/blog/Documents/IRS-Funding\\_Lapse\\_Contingency\\_Plan2011.PDF](http://www.treasury.gov/connect/blog/Documents/IRS-Funding_Lapse_Contingency_Plan2011.PDF) contemplates a lapse in appropriations during filing season.

<sup>5</sup> IRC § 7811 authorizes the National Taxpayer Advocate, by means of a TAO, to require the Secretary of Internal Revenue to release a levy or “cease any action, take any action as permitted by law, or refrain from taking any action, with respect to the taxpayer” when the National Taxpayer Advocate “determines the taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary.”

the agency's function and the safety of the taxpayer's life or the protection of her property, the IRS does not process the taxpayer's return or issue her refund. The taxpayer may ask TAS for assistance, but TAS does not have authority to process returns. Moreover, even if the number of TAS employees permitted to continue working under the IRS contingency plan is sufficient to provide immediate assistance, the number of other IRS employees permitted to continue to work may be insufficient to handle TAS's requests. With no one able to help her obtain a refund, the taxpayer does not pay her utility bills, and the services are disconnected. Without heat and electricity, she cannot remain in her home and is forced to find shelter elsewhere, and cannot buy the medical supplies she needs to treat her diabetes.

### RECOMMENDATION

The National Taxpayer Advocate recommends that Congress clarify that the emergency exception to the Anti-Deficiency Act includes IRS activity involving the safety of human life, including taxpayer life, or the protection of property, including taxpayer property. Alternatively, the National Taxpayer Advocate recommends that Congress clarify that the National Taxpayer Advocate's authority to issue TAOs pursuant to IRC § 7811 continues during a lapse in appropriations and includes the authority to incur obligations in advance of appropriations, and that the IRS can incur obligations in advance of appropriations to comply with any TAO issued under IRC § 7811.

### CURRENT LAW

Article I of the Constitution provides that "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."<sup>6</sup> The Anti-Deficiency Act implements this provision. Section 1341(a)(1)(B) of Title 31 forbids any officer or employee of the United States government or of the District of Columbia government to involve their respective government employers in a contract or obligation for the payment of money before an appropriation is made unless authorized by law.<sup>7</sup> A significant exception to this rule is section 1342 of Title 31, which permits such government activity "for emergencies involving the safety of human life or the protection of property."<sup>8</sup> A similar provision under Title 31, section 1515(b)(1)(B), prohibits the apportionment or reapportionment of appropriated funds in a manner that would give rise to a deficiency or require a supplemental appropriation (*i.e.*, expending funds at a rate that could not be sustained for the entire fiscal

<sup>6</sup> U.S. Const. Art I, § 9, cl. 7.

<sup>7</sup> 31 U.S.C. § 1341(a)(1)(B) (formerly § 665(a), redesignated as § 1341 by Pub. L. No. 97-208, 96 Stat. 921 (1982)). Paying employees in the absence of an appropriation for that purpose is not "authorized by law." Compare with the authority to incur, in advance of appropriations, those minimal obligations necessary to close an agency, which would fall within the "authorized by law" exception to the statute. See *Applicability of the Antideficiency Act Upon A Lapse in Agency Appropriations*, 43 Op. Att'y Gen. 224 (1980).

<sup>8</sup> This portion of the Anti-Deficiency Statute, when it was originally enacted in 1884, forbade unauthorized employment "except in cases of sudden emergency involving the loss of human life or the destruction of property." In 1950, Congress revised this portion of the statute by substituting "cases of sudden emergency" with "cases of emergency," substituting "loss of human life" with "safety of human life," and substituting "destruction of property" with "protection of property." The provision appeared as section 665(b) of Title 31 until 1982 when it was redesignated as § 1342 by Pub. L. No. 97-208, 96 Stat. 921 (1982).

year without a deficiency) except in, among other circumstances, “emergencies involving the safety of human life, [or] the protection of property.”<sup>9</sup> The Attorney General noted that:

Activities for which deficiency apportionments have been granted on this basis [former § 665(e)(1)(B), now § 1515(b)(1)(B)] include FBI criminal investigations, legal services rendered by the Department of Agriculture in connection with state meat inspection programs and enforcement of the Wholesome Meat Act of 1967, the protection and management of commodity inventories by the Commodity Credit Corporation, and the investigation of aircraft accidents by the National Transportation Safety Board. These few illustrations demonstrate the common sense approach that has guided the interpretation of [former § 665(e), now § 1515]. Most important, under § 665(e)(2) [now § 1515(b)(1)(B)], each apportionment or reapportionment indicating the need for a deficiency or supplemental appropriation has been reported contemporaneously to both Houses of Congress, and, in the face of these reports, Congress has not acted in any way to alter the relevant 1950 wording of § 665(e)(1)(B) [now § 1515(b)(1)(B)], which is, in this respect, identical to § 665(b) [now § 1342].<sup>10</sup>

Based on these observations, the Attorney General in 1981 articulated two rules for identifying functions that would fall under the exception of § 1342:

First, there must be some reasonable and articulable connection between the function to be performed and the safety of human life or the protection of property. Second, there must be some reasonable likelihood that the safety of human life or the protection of property would be compromised, in some degree, by delay in the performance of the function in question.<sup>11</sup>

Section 1342 was amended in 1990 to add: “As used in this section, the term ‘emergencies involving the safety of human life or the protection of property’ does not include ongoing, regular, functions of the government the suspension of which would not imminently threaten the safety of human life or the protection of property.”<sup>12</sup> The Attorney General clarified that the earlier interpretation continues to be sound legal analysis, with one modification. The second rule – that there must be some reasonable likelihood that the safety of human life or the protection of property would be compromised, in some degree, by delay

<sup>9</sup> 31 U.S.C. § 665(e)(1)(B), redesignated as § 1515(b)(1)(B) by Pub. L. No. 97-208, 96 Stat. 921 (1982).

<sup>10</sup> *Authority for the Continuance of Government Functions During a Temporary Lapse in Appropriations*, 43 Op. Att’y Gen. 293, 304-305 (1981) (fn. refs. omitted). The Attorney General observed that §§ 665(e)(1)(B) (now § 1515(b)(1)(B)) and 665(b) (now § 1342) “containing the same language, enacted at the same time, and aimed at related purposes...should be deemed *in pari materia* [on the same subject] and given a like construction.” *Id.* note 11.

<sup>11</sup> *Authority for the Continuance of Government Functions During a Temporary Lapse in Appropriations*, 43 Op. Att’y Gen. 293, 302 (1981). Moreover, “Congress would intend those persons so employed to be able to accomplish their emergency functions with success. Congress, for example, having allowed the Government to hire firefighters must surely have intended that water and firetrucks would be available to them.” *Id.* at 306.

<sup>12</sup> See Act of Nov. 5, 1990, Pub. L. No. 101-508, Title XIII, Subtitle B, § 13213(b), 104 Stat. 1388-621 (amending 31 U.S.C. § 1342 (1982)).

in the performance of the function in question – should be modified to replace “in some degree” with “in some significant degree.”<sup>13</sup>

## REASONS FOR CHANGE

The IRS’s shutdown contingency plans permit three categories of activity during a lapse in appropriations: “Activities otherwise authorized by law;” “Activities necessary to safeguard human life or protect *government* property;” and “Activities necessary for orderly agency shutdown.”<sup>14</sup> The only examples the plans provide of permissible activity in the second category that mention the protection of life or property are: “Administering contracts related to safety of human life or protection of Government property,” “Protecting Federal lands, buildings, and other property owned by the United States,” and “Maintaining minimal building facilities personnel to maintain safe conditions for essential Personnel.”<sup>15</sup> Some return processing, and all automated collection activity, would be permissible under the second category of excepted activity. As the filing season contingency plan notes, “as a practical matter, the IRS’s automated tax processing system would not allow for an interruption during the filing season in processing electronically filed tax returns of any kind, whether involving remittances or refunds.”<sup>16</sup> Consequently, the IRS contingency plans provide that it will continue to process e-filed returns, both those with payments and those claiming refunds, to avoid disrupting automated systems.<sup>17</sup> The IRS also will process payments submitted with paper returns because these receipts constitute government property. However, the IRS will not issue refunds claimed on paper returns, and will issue refunds claimed on electronically filed returns only if they would not require manual processing.<sup>18</sup> Nor will the IRS provide taxpayer account assistance by operating service centers or call sites except to the extent that it would enable taxpayers to meet their filing obligations. Even this limited assistance will be available only if the lapse in appropriations occurs

<sup>13</sup> Memorandum for Alice Rivlin, Director, Office of Management and Budget (Aug. 16, 1995) available at [http://www.opm.gov/furlough/OMBGuidance/Attachment\\_A-1.pdf](http://www.opm.gov/furlough/OMBGuidance/Attachment_A-1.pdf).

<sup>14</sup> IRS, *FY 2012 Shutdown Contingency Plan* (Rev. Nov. 16, 2011) (emphasis added), 1-2, available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited Dec. 21, 2011); IRS, *FY 2011 Shutdown Contingency Plan* (Rev. Apr. 7, 2011) 1-3, available at [http://www.treasury.gov/connect/blog/Documents/IRS-Funding\\_Lapse\\_Contingency\\_Plan2011.PDF](http://www.treasury.gov/connect/blog/Documents/IRS-Funding_Lapse_Contingency_Plan2011.PDF).

<sup>15</sup> IRS, *FY 2012 Shutdown Contingency Plan* (Rev. Nov. 16, 2011), 6, available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited Dec. 21, 2011); IRS, *FY 2011 Shutdown Contingency Plan* (Rev. Apr. 7, 2011) 6, available at [http://www.treasury.gov/connect/blog/Documents/IRS-Funding\\_Lapse\\_Contingency\\_Plan2011.PDF](http://www.treasury.gov/connect/blog/Documents/IRS-Funding_Lapse_Contingency_Plan2011.PDF).

<sup>16</sup> IRS, *FY 2011 Shutdown Contingency Plan* (Rev. Apr. 7, 2011), 2, available at [http://www.treasury.gov/connect/blog/Documents/IRS-Funding\\_Lapse\\_Contingency\\_Plan2011.PDF](http://www.treasury.gov/connect/blog/Documents/IRS-Funding_Lapse_Contingency_Plan2011.PDF).

<sup>17</sup> Continuing to operate the automated systems protects the government’s property by maintaining the integrity of the systems and preventing loss of data. Moreover, the IRS cannot determine whether a return is a remittance or a refund return without some processing.

<sup>18</sup> Once an electronically filed refund return clears the automated processing system, manual intervention is required to prevent the issuance of the refund. Conversely, if the processing system interrupts the issuance of the refund, manual processing may be required to issue the refund. Manual processing is required for a number of reasons, such as when a hardship situation necessitates a more rapid refund than normal systemic processing can provide. See IRM 21.4.4.2 (Apr. 11, 2011).

during filing season.<sup>19</sup> Meanwhile, lien and levy activities carried out by automation will continue.<sup>20</sup> While some personnel employed to protect government property could help callers with levy releases, there is no mechanism to ensure that taxpayers facing immediate financial hardship will receive assistance.<sup>21</sup> TAS may be the only place taxpayers can turn for assistance — and under the most recent contingency plan, only 58 TAS employees are authorized to continue to work.<sup>22</sup>

Other federal agencies have not taken such a restrictive view of the emergency exception. For example, the Securities and Exchange Commission's contingency plan provides that it will handle "emergency enforcement matters, including temporary restraining orders and/or investigative steps necessary to protect public and private property" and "emergency examinations and inspections to protect public and private property."<sup>23</sup> The Department of Justice's contingency plan, in addition to permitting activities relating to law enforcement that may or may not affect government property or the lives of government employees,<sup>24</sup> provides that its U.S. Trustees Program will continue to "protect bankruptcy estate property [which is not government property] through the appointment and oversight of fiduciaries and through other means."<sup>25</sup>

<sup>19</sup> IRS, *FY 2011 Shutdown Contingency Plan* (Rev. Apr. 7, 2011), 2, available at [http://www.treasury.gov/connect/blog/Documents/IRS-Funding\\_Lapse\\_Contingency\\_Plan2011.pdf](http://www.treasury.gov/connect/blog/Documents/IRS-Funding_Lapse_Contingency_Plan2011.pdf) ("If a shutdown occurs during the filing season, therefore, 'tax collecting activity,' which is an established excepted function to protect property, may encompass operating service centers and call sites to the extent necessary to enable taxpayers to meet their filing obligation."); IRS, *FY 2012 Shutdown Contingency Plan* (Rev. Nov. 16, 2011), 7, available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited Dec. 21, 2011) (listing as an example of impermissible, non-excepted activities "Taxpayer services such as responding to taxpayer questions (call sites) (during Non-Filing Season)").

<sup>20</sup> See note 17, *supra*, pertaining to continued operations of IRS automated systems. As the National Taxpayer Advocate has observed, "The IRS now generates a majority of its liens through the ACS [Automated Collection System]...Most ACS liens are issued systemically, i.e., the lien-filing determinations are driven by IRS 'business rules' and procedural requirements, with little or no employee involvement or judgment in the decision-making process...In these situations,...the ACS does not determine the impact of the liens on the affected taxpayers, or whether they own any assets requiring a lien to protect the government's interests." National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, *An Analysis of the IRS Collection Strategy: Suggestions to Increase Revenue*, 53 (fn. refs. omitted). The National Taxpayer Advocate also observed, "The use of the systemically generated levy has been the primary ACS contact strategy almost from its inception, and in recent years, from FYs 2006 through 2010, the ACS has averaged approximately 3.4 million levies per year." *Id.* at 52.

<sup>21</sup> IRS, *FY 2011 Shutdown Contingency Plan* (Rev. Apr. 7, 2011), 38, available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited Dec. 21, 2011) refers to 1,263 excepted "ACS [employees] to handle levy release telephone calls from taxpayers." IRS, *FY 2012 Shutdown Contingency Plan* (Rev. Nov. 16, 2011), available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited Dec. 21, 2011) does not contain any provision for retaining employees to assist with levy releases.

<sup>22</sup> IRS, *FY 2012 Shutdown Contingency Plan* (Rev. Nov. 16, 2011), 21, available at <http://www.whitehouse.gov/omb/contingency-plans> (last visited Dec. 21, 2011).

<sup>23</sup> Securities and Exchange Commission, *Plan of Operations During a Lapse in Appropriations* (Dec. 14, 2011), 5 available at [http://www.sec.gov/about/2011\\_fed\\_shutdown\\_contingency\\_plan.pdf](http://www.sec.gov/about/2011_fed_shutdown_contingency_plan.pdf) (last visited Dec. 21, 2011).

<sup>24</sup> For example, "Criminal litigation will continue without interruption as an activity essential to the safety of human life and the protection of property," and employees are to "process all immigration cases and appeals involving detained aliens, including criminal aliens." Moreover, "all operations of the FBI are directed toward national security and investigations of violations of law involving protection of life and property" and are therefore permitted under the emergency exception. Dept. of Justice, *2011 Contingency Plan* (Apr. 7, 2011) 3, 5, 9 available at <http://www.justice.gov/jmd/publications/2011-doj-contingency-plan.pdf> (last visited Dec. 21, 2011).

<sup>25</sup> Dept. of Justice, *2011 Contingency Plan* (Apr. 7, 2011), 7 available at <http://www.justice.gov/jmd/publications/2011-doj-contingency-plan.pdf> (last visited Dec. 21, 2011).

**EXPLANATION OF RECOMMENDATION**

The IRS, during an appropriations lapse, should be able to assist taxpayers whose lives or property may be jeopardized if the IRS does not perform its functions such as issuing refunds, releasing liens and levies, and returning levy proceeds. Clarifying that the emergency exception permits the IRS to protect taxpayer life and property better aligns with other federal agencies' approach. Failing this, IRC § 7811 should be clarified to provide that the National Taxpayer Advocate's authority to issue TAOs continues during a lapse in appropriations and includes the authority to incur obligations in advance of appropriations, and that the IRS has the authority to incur obligations in advance of appropriations to comply with any TAOs. This would ensure that TAS would have enough employees working to provide immediate emergency assistance to taxpayers, and that the IRS would have sufficient staff to handle TAS's requests for help.

LR  
#9

## Assessment of Civil Penalties Against Preparers of Fraudulent Returns

### PROBLEM

There is a small segment of the tax return preparer community who defraud taxpayers and the IRS by altering the taxpayers' returns without their knowledge. A number of these cases involved fraudulent schemes in which paid return preparers completed and taxpayers signed correct tax returns that claimed refunds, but which the preparers then altered without the taxpayers' knowledge to claim increased refunds that the taxpayers were not entitled to receive.<sup>1</sup> The preparers filed the altered returns with the IRS, which either remitted the entire inflated refunds to the preparers, who then wire transferred the amounts the taxpayers were expecting into each taxpayer's bank account (*i.e.*, the amounts shown on the correct returns), or split the refund between the preparer's and taxpayer's bank accounts, as indicated on the return.<sup>2</sup>

In such cases, the IRS later discovers that the taxpayer is not entitled to all of the refund claimed on the filed return, but does not know that the return was altered without the taxpayer's knowledge. The IRS therefore attempts to retrieve the excess refund from the unsuspecting taxpayer. There needs to be a sizeable monetary penalty to discourage return preparers from engaging in this type of behavior.

### EXAMPLE

A taxpayer is due a refund of \$350. After completing a return that claims the refund and shows no income tax liability, and giving the taxpayer a copy, the preparer alters the return before filing it electronically. He inflates the taxpayer's income and credit for withholding to show a liability of \$500 and withholding of \$3,850, increasing the refund to \$3,350. The preparer designates his own bank account to receive \$3,000 as a direct deposit, and the taxpayer's account to receive \$350. The taxpayer receives the refund she was expecting and is entitled to, while the preparer fraudulently takes \$3,000 without her knowledge.

The IRS assesses the \$500 liability on the filed return but on later review finds the taxpayer is only entitled to \$350 in credits instead of the \$3,850 shown, leaving a \$150 balance due. It therefore seeks to recover the entire \$3,350 refund from the taxpayer, as well as the \$150 liability it believes she owes. The taxpayer responds that she only claimed \$350 in credits and had no liability due. She provides the IRS with a copy of the return that the preparer

<sup>1</sup> Through fiscal year 2011, TAS had approximately 140 alleged preparer fraud cases open. TAS, 2011 Refund Fraud CTA Case Referrals (on file with the Taxpayer Advocate Service). For a detailed discussion of the IRS's failure to implement procedures providing relief to taxpayers who are victims of preparer fraud, see *Most Serious Problem: Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*, *supra*. See also Proposed Taxpayer Advocate Directive (TAD) 2011-1 (June 13, 2011).

<sup>2</sup> Internal Revenue Code (IRC) § 6402(a) provides that the IRS shall refund any overpayment of tax to the person who made the overpayment. IRS Form 8888, *Allocation of Refund (Including Savings Bond Purchases)*, allows a taxpayer to specify up to three different accounts into which a refund can be direct-deposited.

had provided to her, which is the return she intended to file. The IRS then accepts that copy as her original return, and agrees she was entitled to a refund of \$350. Yet the government has lost revenue of \$3,000 (the amount the preparer fraudulently obtained), which cannot be collected from the preparer through administrative means because it is not a tax liability of the preparer.

## RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend the Internal Revenue Code to provide that when the issuance of an erroneous refund to a return preparer is due to fraud, the IRS may impose a penalty, in addition to other penalties provided by law, equal to 100 percent of that erroneous refund.

## PRESENT LAW

### **A return altered by a preparer without the taxpayer's consent is not a valid return.**

In general, there is a four-part test (often referred to as the *Beard*<sup>3</sup> test or substantial compliance standard) for determining whether a document is a valid tax return: “First, there must be sufficient data to calculate tax liability; second, the document must purport to be a return; third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury.”<sup>4</sup>

The *Beard* requirement to sign a return under penalties of perjury derives from Internal Revenue Code section 6065, which provides that generally, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under penalties of perjury. The purpose of this requirement is to authenticate the signed document, and to verify its truthfulness. A return that does not comply with section 6065 fails the fourth prong of the *Beard* test. The requirement under *Beard* that a return be executed under penalties of perjury is absolute.<sup>5</sup> Signing the jurat included on a Form 1040 or Form 8879,<sup>6</sup> for electronically filed tax returns, satisfies the requirement that the return is executed under the penalties of perjury.

In cases in which the taxpayer is unaware of a tax return preparer's fraudulent alteration of items of income, deductions, credits, or withholding after the taxpayer signed the tax return (or the Form 8879), the taxpayer has not executed the document under penalties of perjury. Thus, the return the preparer filed with the IRS is not the taxpayer's return, and

<sup>3</sup> *Beard v. Comm'r*, 82 T.C. 766 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

<sup>4</sup> *Beard*, 82 T.C. at 777.

<sup>5</sup> See, e.g., *Hettig v. United States*, 845 F.2d 794 (8th Cir. 1988); *United States v. Moore*, 627 F.2d 830, 834 (7th Cir. 1980) (citations omitted).

<sup>6</sup> Form 8879, *IRS e-file Signature Authorization*, is the declaration document that a taxpayer must sign under penalties of perjury, reflecting that he or she has reviewed a copy of the return that the preparer will be filing electronically.

does not meet the Beard test. Consequently, that return is invalid. The IRS Office of Chief Counsel (Counsel) has concurred with this interpretation, and has advised that the taxpayer should submit his or her true original return upon discovering the fraudulent actions of the preparer.<sup>7</sup> Moreover, Counsel has advised that the IRS should adjust the taxpayer's account to remove all entries attributable to the purported return filed by the preparer.<sup>8</sup>

**The IRS has limited remedies for penalizing a preparer who commits fraud against a taxpayer, and for recouping a taxpayer's refund that was diverted inappropriately into the preparer's bank account.**

The IRS has limited authority to recoup an erroneous refund<sup>9</sup> from a preparer who has defrauded the taxpayer and the government. Because the funds the preparer received by virtue of his fraudulent actions are not a tax liability that the preparer owes, the IRS cannot administratively recover those funds using erroneous refund procedures.<sup>10</sup> Instead, the IRS's only remedy to recover the refund is to request the Department of Justice (DOJ) to file a civil action, but only if the Attorney General authorizes the filing of a suit and recovers the erroneous refund on behalf of the United States.<sup>11</sup> Such litigation, however, is costly to the government, particularly in low-dollar amount cases.

Internal Revenue Code section 6695(f) imposes a \$500 penalty on a preparer who negotiates a taxpayer's refund check.<sup>12</sup> In regulations promulgated under section 6695(f), the IRS and Treasury have interpreted the penalty to apply to a preparer who negotiates "a check (including an electronic version of a check."<sup>13</sup> Nothing in the preamble to those regulations, however, makes clear that "electronic version of a check" is the same as direct deposit. Thus, arguably the section 6695(f) penalty is not applicable to a preparer who diverts a taxpayer's refund via direct deposit into the preparer's bank account.

The IRS may impose a civil penalty of 20 percent of the amount in excess of an allowable claim for credit or refund where there is no reasonable basis for the claim.<sup>14</sup> In addition,

<sup>7</sup> PMTA 2011-20, *Tax Return Preparer's Alteration of a Return* (June 27, 2011); PMTA 2011-13, *Horse's Tax Service* (May 12, 2003).

<sup>8</sup> IRS, Office of Chief Counsel, POSTN-145098-08, *Refunds Improperly Directed to a Preparer* (Dec. 17, 2008).

<sup>9</sup> An "erroneous refund" is defined as the receipt of any payment from the IRS to which the recipient is not entitled. IRM 21.4.5.1(2) (Oct. 1, 2006).

<sup>10</sup> Although the refund remitted to the preparer's bank account is an erroneous refund within the meaning of IRC § 7405, the government is unable to use assessment procedures to administratively collect that refund against the preparer, as the amount is not a tax liability of the preparer. See IRM 21.4.5 (Sept. 16, 2011). The IRS can, however, request that the Department of Justice file an erroneous refund suit against the preparer. See IRM 34.6.2.7 (Aug. 11, 2004).

<sup>11</sup> IRC § 7401 generally prohibits any civil action for the recovery or collection of taxes unless authorized by the Secretary of the Treasury, or his or her delegate, and directed by the Attorney General, or his or her delegate. IRC § 7405 provides that an erroneous refund may be collected by filing a civil suit brought in the name of the United States. The suit must be filed within five years of the erroneous refund if it appears that any part of the refund was induced by fraud or misrepresentation of a material fact as provided by IRC § 6532(b).

<sup>12</sup> Similarly, section 10.31 of Circular 230 (31 C.F.R. Part 10) prohibits a tax practitioner who prepares tax returns from endorsing or negotiating a client's federal tax refund check.

<sup>13</sup> Treas. Reg. § 1.6695-1(f)(1).

<sup>14</sup> IRC § 6676 applies to any person making a claim, not specifically the taxpayer, and is only available if a penalty under Part II of Chapter 68A does not apply. IRC § 6664(b) provides that penalties under Part II of Chapter 68A (e.g., section 6662) only apply where a valid return is filed. Thus, if the taxpayer can prove the return filed by the preparer is not a valid return, the section 6662 accuracy-related penalty is not applicable, and therefore the IRS could apply the section 6676 penalty.

a preparer penalty of \$50 per return for failing to furnish a copy of the filed return may apply,<sup>15</sup> or a penalty of the greater of \$5,000 or 50 percent of the income derived by the preparer for willful or reckless understatement of liability may apply.<sup>16</sup> The IRS can also ask the DOJ to seek an injunction or criminal penalties in court.<sup>17</sup>

### REASONS FOR CHANGE

While the IRS may request that the DOJ seek court action to collect erroneous refunds, such litigation is costly to the government, particularly in low-dollar amount cases. Moreover, if the document filed by the preparer is not a valid return under the *Beard* test, many of the penalties applicable to preparers are not available, because they require a valid return to trigger liability. In addition, even if the IRS is able to assert a penalty (*e.g.*, section 6695(f) for diverting a taxpayer's refund via direct deposit), the amount of the penalty is generally far below the amount received by the preparer. Thus, the currently available remedies fall short in fully recovering the erroneous fraudulent refund, and may not adequately deter preparers from engaging in fraud.

### EXPLANATION OF RECOMMENDATION

The recommendation permits the IRS to assert a penalty equal to 100 percent of any refund obtained by a preparer through the fraudulent alteration of a taxpayer's return without the taxpayer's knowledge. Such a penalty would be consistent with the IRS's policy on penalties; penalties are to be used to enhance compliance and deter inappropriate conduct.<sup>18</sup> Moreover, consistent with other civil penalties involving fraudulent activity, the IRS should have the burden of proof with respect to the penalty.

<sup>15</sup> IRC § 6695(a).

<sup>16</sup> IRC § 6694(b), providing that the preparer must be a tax return preparer who "prepares any return or claim for refund with...an understatement of liability... [in] (A) a willful attempt in any manner to understate the liability for tax on the return or claim, or (B) a reckless or intentional disregard of rules or regulations."

<sup>17</sup> IRC § 7407 permits the DOJ to file a civil action to enjoin any tax return preparer from further engaging in willful or reckless conduct in preparation of a return, failing to provide a copy of the filed return to the taxpayer, or any conduct subject to a criminal penalty. IRC § 7207 imposes a fine of not more than \$10,000 and imprisonment of not more than a year, or both for submission of a false or fraudulent return.

<sup>18</sup> See Policy Statement 20-1 (Formerly P-1-18), IRM 1.2.20.1.1 (June 29, 2004).

LR  
#10**Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant****PROBLEM**

When an organization's exempt status under Internal Revenue Code (IRC) § 501(c)(3) is revoked, the organization becomes subject to tax and its donors can no longer deduct their contributions. Administrative appeal rights generally allow exempt organizations (EOs) to contest revocation.<sup>1</sup> On June 8, 2011, the IRS notified approximately 275,000 organizations that, under the Pension Protection Act of 2006 (PPA), their exempt status had been *automatically* revoked because they failed to file returns for three consecutive years.<sup>2</sup> The PPA does not prohibit administrative review of an IRS conclusion that an organization's exempt status was automatically revoked. However, the IRS declines to provide such a review, instead advising taxpayers to simply contact the IRS in the event of a dispute, or to apply for reinstatement.<sup>3</sup>

The PPA does not prescribe any particular IRS form to apply for reinstatement as an IRC § 501(c)(3) organization. However, the IRS requires organizations to fill out a full Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, which the IRS estimates takes *more than two weeks* to complete.<sup>4</sup> Small charities, which constitute the majority of the "revoked" organizations, could provide sufficient information on a shorter "Form 1023-EZ" if the IRS made one available.<sup>5</sup>

The user fee for filing Form 1023 is usually \$400 for organizations with gross receipts of \$10,000 or less and \$850 for those with gross receipts in excess of \$10,000.<sup>6</sup> In 2009, taxpayers were informed that if they prepared Form 1023 using Cyber Assistant, a web-based software program that the IRS is developing, they would pay only \$200, a savings of either

<sup>1</sup> Rev. Proc. 2011-9, 2011-2 I.R.B. 283, secs. 12 and 7 (Jan. 10, 2011).

<sup>2</sup> See IR-2011-63, *IRS Identifies Organizations that Have Lost Tax Exempt Status; Announces Special Steps to Help Revoked Organizations* (June 8, 2011), available at <http://www.irs.gov/newsroom/article/0,,id=240239,00.html?portlet=7>; Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006). For a detailed discussion of automatic revocation of tax-exempt status, see Most Serious Problem: *The IRS Makes Reinstatement Following Automatic Revocation of Exempt Status Unnecessarily Burdensome*, *supra*.

<sup>3</sup> See, e.g., Automatic Exemption Revocation for Non-Filing: Frequently Asked Questions, available at <http://www.irs.gov/charities/article/0,,id=237750,00.html> and at <http://www.irs.gov/charities/article/0,,id=241119,00.html>.

<sup>4</sup> IRS Instructions for Form 1023 at 24. The estimated time for completing the main form, consisting of Parts I-XI, includes estimated times for recordkeeping (89 hours, 26 minutes), learning about the law or the form (five hours, ten minutes), preparing the form (nine hours, 39 minutes), copying and assembling the form, and sending it to the IRS (48 minutes). In addition to completing Parts I-XI, taxpayers may be required to submit one or more of Schedules A-H. The IRS estimates each of Schedules A-H takes on average more than ten hours to complete, including recordkeeping, learning about the law or the form, preparing the form, and copying, assembling and sending the form to the IRS. See Most Serious Problem: *The IRS Makes Reinstatement Following Automatic Revocation of Exempt Status Unnecessarily Burdensome*, *supra*.

<sup>5</sup> Of the "revoked" organizations for whom information is available, most were public charities that had last reported revenue of less than \$25,000. See Most Serious Problem: *The IRS Makes Reinstatement Following Automatic Revocation of Exempt Status Unnecessarily Burdensome*, *supra*.

<sup>6</sup> Rev. Proc. 2011-8, 2011-1 I.R.B. 237 (Jan. 3, 2011). Organizations eligible for transitional relief may submit their reinstatement application by Dec. 31, 2012, for a reduced user fee of \$100. See Notice 2011-43, 2011-25 I.R.B. 882 (June 9, 2011); Rev. Proc. 2011-36, 2011-25 I.R.B. 915 (June 9, 2011).

Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant

LR #10

50 percent or 76 percent over the usual user fee.<sup>7</sup> Cyber Assistant will not replace the paper application form, which the applicant will still print and mail to the IRS, but it will help applicants avoid making errors or leaving mandatory sections of the form incomplete, an improvement that will benefit taxpayers and the IRS. For most EOs, particularly those in their first year of operation, for whom every penny counts, using an additional \$650 for program services rather than as an IRS user fee is an important opportunity. Some EOs may have even delayed filing their Forms 1023, preferring to wait for the reduced user fee and increased efficiency Cyber Assistant would bring.<sup>8</sup> However, the release of Cyber Assistant has been delayed until further notice.<sup>9</sup>

### EXAMPLE

Generally, a parent exempt organization files “group returns” on behalf of subordinate chapters, relieving them of a separate filing requirement.<sup>10</sup> An incoming officer, uninformed that the chapter already had an employer identification number (EIN) that appeared on the group return, obtained a duplicate number. Unable to associate the second EIN with the group return, the IRS assumed that the chapter did not meet the applicable requirement and listed it as automatically revoked for failure to file for three years in a row. According to IRS materials on revoked subordinates, “if an organization’s tax-exempt status is revoked for failure to file for three years, the only way it can get that status reinstated is to apply for exemption.”<sup>11</sup> No administrative review process is available or publicized to straighten out this factual misunderstanding.

### RECOMMENDATIONS

The National Taxpayer Advocate recommends that Congress:

1. Require the IRS to allow administrative review of its conclusion that an organization’s exempt status was automatically revoked.
2. Require the IRS to develop a Form 1023-EZ.
3. Require and provide sufficient funding for the IRS to implement Cyber Assistant for use in preparing applications for recognition of exempt status.

<sup>7</sup> See IRS Notice 1382 (Rev. Sept. 2009) advising taxpayers that Cyber Assistant would become available in 2010 and the user fee for applications prepared using Cyber Assistant would be \$200.

<sup>8</sup> See Brian Cave Charitable Group, *Patience Is a Virtue – and Can Also Save Money* (Oct. 19, 2010), available at <http://bryancavecharitylaw.com/patience-is-a-virtue-and-can-also-save-you-money/> (advising readers that “A major advantage of the cyber assistant will be a significant reduction in the application fee...As 2010 winds down, newly formed charities may want to delay filing the Form 1023 application until the cyber assistant is available”).

<sup>9</sup> Internal Revenue Manual (IRM) 3.45.1.10.6.2 (Mar. 29, 2011), available at <http://serp.enterprise.irs.gov/databases/irm.dr/current/3.dr/3.45.dr/3.45.1.dr/3.45.1.10.6.2.htm>.

<sup>10</sup> Instructions for Form 990 Return of Organization Exempt From Income Tax (2010), Appdx. E; see also Brian Tumulty, *IRS Still Trying to Weed Out Defunct Non-profits*, USA Today (June 28, 2011).

<sup>11</sup> FAQ 26 at <http://www.irs.gov/charities/article/0,,id=241119,00.html> (last visited Oct. 24, 2011).

## CURRENT LAW

The PPA imposed a new annual filing requirement on small exempt organizations (generally, those with gross receipts of \$25,000 or less) and provides that the exempt status of any EO failing to file for three consecutive years is automatically revoked.<sup>12</sup> The purpose of the new filing requirement is to ensure that the IRS can maintain a reliable record of small EOs' continuing existence, that the public can easily obtain basic information about an organization, such as its current address, and that the IRS will know when to omit EOs from its published list of organizations to which charitable contributions may be made.<sup>13</sup> Judicial review of automatic revocations is not available, but the PPA does not prohibit administrative review of the IRS's conclusion that an EO's exempt status was revoked.<sup>14</sup> The statute requires organizations whose exempt status was automatically revoked to apply for reinstatement, but does not specify the precise method for making the application.<sup>15</sup>

## REASONS FOR CHANGE

The consequences of revocation may be severe, yet there is no mechanism for an organization to obtain review of a claim that the IRS erred in concluding that its exempt status was automatically revoked. EOs that consult the IRS website for more information may simply be advised to apply for reinstatement. The application for reinstatement is Form 1023, the same form used to request initial recognition of exempt status. The IRS estimates the form takes more than two weeks to complete.<sup>16</sup> The checklist alone that lists all the documents taxpayers must submit with the form is over a page long.<sup>17</sup> Moreover, the IRS has not articulated how it plans to use the information it obtains from the Forms 1023 filed by EOs seeking reinstatement.<sup>18</sup>

Small EOs may qualify for transitional relief that allows them to submit Form 1023 by December 31, 2012, for a reduced user fee of \$100.<sup>19</sup> Otherwise, the fee for filing Form 1023 is \$400 for EOs with gross receipts of \$10,000 or less and \$850 for those with gross receipts of over \$10,000.<sup>20</sup> In 2009, the IRS advised the public that Cyber Assistant would be available in 2010 and the user fee for Forms 1023 prepared using Cyber Assistant would be \$200, regardless of the size of the organization.<sup>21</sup> Some EOs had to decide whether

<sup>12</sup> Pension Protection Act of 2006, Pub. L. No. 109-280 § 1223, 120 Stat. 780, 1090 (2006). The \$25,000 threshold is now \$50,000. Rev. Proc. 2011-15, 2011-3 I.R.B. 322.

<sup>13</sup> See S. Rep. No. 109-336 (2006) 41, accompanying S. 1321, The Telephone Excise Tax Repeal and Taxpayer Protection and Assistance Act of 2006, Tit. III, W. Notification Requirement for Exempt Entities Not Currently Required to File an Annual Information Return.

<sup>14</sup> IRC § 7428(b)(4).

<sup>15</sup> IRC § 6033(j)(2).

<sup>16</sup> IRS Instructions for Form 1023 at 24.

<sup>17</sup> IRS Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, 27-28.

<sup>18</sup> See Most Serious Problem: *The IRS Makes Reinstatement of an Organization's Exempt Status Following Automatic Revocation Unnecessarily Burdensome*, *supra*.

<sup>19</sup> See Rev. Proc. 2011-36, 2011-25 I.R.B. 915 (June 20, 2011).

<sup>20</sup> Rev. Proc. 2011-8, 2011-1 I.R.B. 237 (Jan. 3, 2011).

<sup>21</sup> IRS Notice 1382 (Rev. Sept. 2009).

Provide Administrative Review of Automatic Revocations of Exempt Status, Develop a Form 1023-EZ, and Reduce Costs to Taxpayers and the IRS by Implementing Cyber Assistant

LR #10

to file the Form 1023 in 2009 or wait for the advent of Cyber Assistant.<sup>22</sup> The IRS then announced, in May 2010, that the release of Cyber Assistant would be delayed until 2011.<sup>23</sup> The uncertainty has now been resolved for 2011 because Cyber Assistant is not yet available and the IRS does not know when it will be ready.<sup>24</sup> Therefore, EOs can now expect to spend \$200 or \$650 more on an IRS user fee that might have been applied to direct program services.

### EXPLANATION OF RECOMMENDATION

Requiring the IRS to afford administrative review of automatic revocations merely recognizes that the IRS may err in concluding that an organization is no longer exempt. Taxpayers should have means of obtaining relief when that error occurs, rather than being required to reapply for recognition of exempt status. Although the IRS may provide such reviews on an ad hoc basis, standards of tax administration and administrative procedure dictate that the IRS should establish and make public the process for EOs to request a review.

Requiring the IRS to develop a Form 1023-EZ would lessen taxpayer burden without depriving the IRS of any information it currently tracks or uses. Providing funding for and requiring the IRS to implement Cyber Assistant would improve the accuracy and consistency of applications, thereby conserving resources for taxpayers and the IRS. The reduced user fee is especially important to these taxpayers, especially in this economy, because it would free resources that could be used for EOs' direct program services. Both a Form 1023-EZ and Cyber Assistant would make it easier for EOs to remain compliant with their reporting obligations.

<sup>22</sup> See, e.g., the Hodgen Law Group PC blog (Nov. 10, 2009), available at <http://hodgen.com/irs-cyber-assistant-professional-fees-evaporate/> ("Hmmm... Here's my problem...I have to decide whether or not to go ahead and file before the 3rd of Jan, which more than likely would cost me \$850 (although I fear I might be misunderstanding their 4 year \$10,000 guideline)...or...do I wait, use whatever money I have now to put into the organization, and just wait for the Cyber Assistant to come around, which would save me \$600???" ).

<sup>23</sup> See Grant Williams, *IRS Announces Delay in New Tool for Groups Seeking Charity Status*, Chronicle of Philanthropy, May 17, 2010, available at <http://philanthropy.com/blogs/government-and-politics/irs-announces-delay-in-new-tool-for-groups-seeking-charity-status/24007>.

<sup>24</sup> IRM 3.45.1.10.6.2 (Mar. 29, 2011), available at <http://serp.enterprise.irs.gov/databases/irm.dr/current/3.dr/3.45.dr/3.45.1.dr/3.45.1.10.6.2.htm>. Rev. Proc. 2011-8, 2011-1 I.R.B. 237, sec. 2.06 (Jan. 3, 2011) states "The references...to application fees after Cyber Assistant availability have been removed because the Service does not expect Cyber Assistant...to become available in 2011."

LR  
#11**Allow Individual U.S. Taxpayers Residing Abroad the Option to Choose the Currency of Their Country of Residence as Their Functional Currency****PROBLEM**

For millions of U.S. taxpayers living abroad, the measurement of U.S. taxable income may be complicated and distorted when those taxpayers receive wages and other income or pay expenses in a foreign currency.<sup>1</sup> Current law requires taxpayers to make all federal income tax determinations in their functional currencies.<sup>2</sup> Generally, individual U.S. taxpayers must use the U.S. dollar as their functional currency.<sup>3</sup> This requirement raises two problems.

First, taxpayers receiving payments in a foreign currency must translate into dollars all the income they receive and all the deductible expenses they pay in the foreign currency, using the prevailing exchange rate as of the date each item of income or expense is paid, received, or accrued.<sup>4</sup> Second, currency fluctuations may create capital gains even on routine personal transactions.<sup>5</sup>

Individual U.S. taxpayers abroad are not afforded the flexibility currently extended to U.S. businesses, whose foreign branches may use the currencies of the countries where their business units are conducting economic activities, but can elect the U.S. dollar as a functional currency if certain criteria are met.<sup>6</sup> Individuals may be confused by the multitude and volatility of exchange rates and are subject to the additional burdens of properly substantiating these rates, tracking the basis of acquired foreign currency, and making multiple calculations for U.S. tax purposes, which may differ from the tax determinations they make in local currency for their country of residence.<sup>7</sup>

<sup>1</sup> An estimated five million to seven million U.S. citizens reside abroad. IRS, *Reaching Out to Americans Abroad* (Apr. 2009), <http://www.irs.gov/businesses/article/0,,id=205889,00.html>; W&I Research Study Report, *Understanding the International Taxpayer Experience: Service Awareness, Use, Preferences, and Filing Behaviors* (Feb. 2010) (citing U.S. Department of State data). This number does not include U.S. troops stationed abroad.

<sup>2</sup> Internal Revenue Code (IRC) § 985; Treas. Reg. § 1.985-1. Prior to 1986, the IRC did not contain express statutory rules for determining the character, amount, and timing of exchange gains or losses arising from fluctuations in the value of foreign currency. See Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986).

<sup>3</sup> IRC § 985; Treas. Reg. § 1.985-1(b).

<sup>4</sup> The IRS does not have official exchange rates and generally accepts any posted exchange rate that is used consistently. The IRS website refers to three government and three external resources for exchange rates. See IRS, *Foreign Currency and Currency Exchange Rates*, <http://www.irs.gov/businesses/small/article/0,,id=130524,00.html> (last visited Sept. 25, 2011).

<sup>5</sup> See generally IRC §§ 988; 1001; 1011-1023; Treas. Reg. § 1.988-2; Rev. Rul. 74-7, 1974-1 C.B. 198.

<sup>6</sup> Qualified business units (QBUs) of U.S. businesses are required to use the currency of the economic environment where a significant part of QBU activities are conducted as their functional currency, provided the QBU keeps its books and records in that currency. IRC §§ 985(b), 989; Treas. Reg. §§ 1.985-1, 1.989(a)-1. A QBU that would be required to use a hyperinflationary currency as its functional currency may elect to use the U.S. dollar as a functional currency if certain criteria are met. See generally IRC §§ 985(b)(3); Treas. Reg. § 1.985-3.

<sup>7</sup> For example, the IRS website contains a link to an external site ([www.oanda.com](http://www.oanda.com)) as a source of historic currency exchange rates that provides 11 different types of rates (and three additional sub-rates within these rates) by date and a selling and a buying exchange rate for each date. See, e.g., OANDA website, <http://www.oanda.com/currency/converter/> (last visited Sept. 23, 2011). It is unclear how many taxpayers observe these rules. There is no evidence that the IRS strictly enforces them.

Verifying multiple exchange-rate computations for personal transactions and substantiation of spot exchange rates at the time the transaction took place in an IRS audit makes the administration of these provisions extremely difficult.<sup>8</sup> It precludes the IRS from undertaking any reasonable or effective compliance initiative in this area.

Requiring individual U.S. taxpayers residing in a foreign country to use the U.S. dollar as their functional currency creates confusion and uncertainty, makes compliance difficult, and places an unnecessary administrative burden on the IRS.<sup>9</sup>

### EXAMPLE

A married couple, H and W, are U.S. citizens and *bona fide* residents of country A. H works for a branch of a U.S. corporation in the country and W is employed by a local business. Both are paid in local currency (LC).

Each year, H and W file returns and pay taxes in country A. They maintain their records and calculate their income for tax reporting purposes in country A in LC and convert these amounts to U.S. dollars solely to compute their U.S. tax liability. This means they have to research exchange rates for each transaction and make tax determinations in dollars. Although H and W spend hundreds of hours computing their income and expenses in dollars, they are not sure if they have used a correct exchange rate because of the multitude and volatility of rates. If the IRS audits their returns, it would need to verify the conversion of all items of income and deductible expenses into dollars, creating a significant commitment of time and resources for its Examination function.

### RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend Internal Revenue Code (IRC) § 985 to allow individual U.S. taxpayers residing abroad:

1. To adopt the local currency as their functional currency with respect to certain activities associated with their residence in a foreign country (*e.g.*, activities of a qualified residence unit or QRU), giving individuals the flexibility currently extended to business taxpayers; and
2. To use an average exchange rate or other reasonable method of accounting to convert foreign currency into U.S. dollars in order to determine the individual's taxable income and gain for taxpayers who do not adopt the QRU and have the U.S. dollar as their functional currency for the taxable year.

<sup>8</sup> The spot rate is generally the rate reflecting a fair market rate of exchange available to the public under a spot contract in a free market and involving representative amounts. A spot contract is a contract to buy or sell nonfunctional currency on or before two business days following the execution of the contract. See Treas. Reg. § 1.988-1(b) and (d).

<sup>9</sup> See National Taxpayer Advocate 2009 Annual Report to Congress 139.

## PRESENT LAW

IRC § 985(a) generally requires that all income tax determinations (*e.g.*, computations of taxable income or loss) be made in a taxpayer's functional currency.<sup>10</sup> A taxpayer's functional currency is the dollar, except in the case of a qualified business unit that conducts a significant part of its activities in an economic environment with a different currency and keeps its books and records in that currency.<sup>11</sup> A QBU is a separate, clearly identified unit of a trade or business of a taxpayer that maintains separate books and records.<sup>12</sup> A QBU is generally required to use the currency of the economic environment in which a significant part of that QBU's activities are conducted and which that QBU uses in keeping its books and records.<sup>13</sup> Generally, such a QBU will compute income or loss in its functional currency, converting the overall results of its operations for a taxable year into U.S. dollars to report on the U.S. tax return at the end of the year, using the average exchange rate for the taxable year.<sup>14</sup> A QBU that would be required to use a hyperinflationary currency as its functional currency may elect to use the U.S. dollar as a functional currency if certain criteria are met.<sup>15</sup>

An individual is not a QBU.<sup>16</sup> Therefore, individual U.S. taxpayers' functional currency is the U.S. dollar. Any such taxpayers receiving payments in a foreign currency must translate into dollars all the income they receive and all the deductible expenses they pay in foreign currency, using the prevailing exchange rate as of the date each item of income or expense is paid, received, or accrued.<sup>17</sup> Although an individual is not a QBU, an individual may have a QBU if it conducts activities constituting a trade or business and maintains a separate set of books and records with respect to those activities.<sup>18</sup> An individual's activities as an employee do not constitute a trade or business for these purposes.<sup>19</sup>

As a general rule, the receipt or payment of an amount denominated in a currency other than the functional currency of the taxpayer is treated as the acquisition or disposition of

<sup>10</sup> IRC § 985(a); Treas. Reg. § 1.985-1(a). The QBU must keep its books and records in that currency.

<sup>11</sup> IRC § 985(b); Treas. Reg. § 1.985-1(b).

<sup>12</sup> IRC § 989(a); Treas. Reg. § 1.989(a)-1.

<sup>13</sup> IRC § 985(b); Treas. Reg. §§ 1.985-1(c); 1.985-3.

<sup>14</sup> See *generally* IRC § 987. Under proposed section 987 regulations issued in 2006, depreciation must be translated at the historic exchange rate when the asset was purchased. Under the proposed section 987 regulations issued in 2006, currency gain or loss on the QBU's financial assets is taken into account when the QBU makes a remittance of property to the owner of the QBU.

<sup>15</sup> See *generally* IRC § 985(b)(3); Treas. Reg. § 1.985-3.

<sup>16</sup> Treas. Reg. § 1.989-1(b)(2). Although an individual may have a QBU that uses a non-dollar functional currency, an activity that does not generate deductible expenses under either IRC §§ 162 or 212 does not qualify as a QBU. Treas. Reg. § 1.989(a)-1(b) and (c). Therefore, an individual cannot have a QBU based on activities that do not constitute a trade or business, typically including an individual's activities as an employee. Treas. Reg. § 1.989(a)-1(b)(2)(ii) and (c).

<sup>17</sup> IRC § 985; Treas. Reg. § 1.985-1.

<sup>18</sup> Treas. Reg. § 1.989(a)-1(b)(2)(ii).

<sup>19</sup> Treas. Reg. § 1.989(a)-1(c).

property.<sup>20</sup> Exchange gain from the disposition of nonfunctional currency is the excess of the amount realized over the adjusted basis of the currency, and exchange loss is the excess of the adjusted basis of the currency over the amount realized.<sup>21</sup> Upon the disposition of a nonfunctional currency, a taxpayer generally must recognize gain or loss resulting from fluctuations in exchange rates that have occurred since the taxpayer acquired that currency.<sup>22</sup> This foreign currency gain or loss is calculated separately from any gain or loss on the underlying transaction and is treated as ordinary gain or loss.<sup>23</sup> Exchange gain of an individual of \$200 or less on the disposition of nonfunctional currency in a personal transaction is not recognized.<sup>24</sup> Individuals are not allowed a deduction for losses resulting from the devaluation of a foreign currency in a personal transaction.<sup>25</sup>

For the purposes of determining the source of foreign currency gain or loss, the residence of an individual U.S. citizen or resident alien is the country in which such individual's tax home is located.<sup>26</sup>

## REASONS FOR CHANGE

Although individual U.S. taxpayers residing abroad may calculate their foreign income tax liability in a foreign currency, they must use the U.S. dollar as a functional currency and translate all income and expense items denominated in foreign currency into dollars as of the date such income and expenses are paid, received, or accrued solely to compute their U.S. tax liabilities.<sup>27</sup> Because foreign currency is property for federal tax purposes, taxpayers must track the basis of foreign currency received. For any individual, this is challenging.

<sup>20</sup> Nonfunctional currency is considered to be "property" for U.S. federal tax purposes. IRC §§ 988; 1001(b); 1011-1023; Treas. Reg. § 1.988-2(a)(1)(i). See also *Philip Morris Inc. v. Comm'r*, 71 F.3d 1040 (2d Cir. 1995), *aff'g* 104 T.C. 61 (1995); *National-Standard Company v. Comm'r*, 749 F.2d 369 (6th Cir. 1984), *aff'g* 80 T.C. 551 (1983); Rev. Rul. 74-7, 1974-1 C.B. 198.

<sup>21</sup> Treas. Reg. § 1.988-2(a)(2)(ii)(A). Generally, gain or loss from the disposition of nonfunctional currency is treated as ordinary income or loss. See IRC § 988(a)(1). Individuals' nonfunctional currency gains or losses arising from "personal transactions" are not subject to section 988, and thus are subject to general timing, source, and character rules of the IRC. See H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., at II-669 (1986); S. Rep. No. 313, 99th Cong., 2d Sess., at 469 (1986). Gains on certain *de minimis* personal transactions are excludable entirely. See footnote 25.

<sup>22</sup> See generally IRC § 988(c)(1)(C).

<sup>23</sup> IRC § 988(a). Treas. Reg. § 1.988-1(a)(1). For discussion of the separate transaction principle, see, e.g., *Helburn v. Comm'r*, 214 F.2d 815 (1st Cir. 1954); *Church's English Shoes, Ltd., v. Comm'r*, 24 T.C. 56 (1955), *aff'd, per curiam* 229 F.2d 957 (2nd Cir. 1956); Rev. Rul. 78-281, 1978-2 C.B. 204.

<sup>24</sup> The term "personal transaction" means any transaction that does not result in a deductible trade or business expense under IRC § 162 (including an individual's currency exchange transactions that are entered into in connection with business travel) or an expense incurred in the production of income under IRC § 212 (other than expenses incurred in connection with taxes). See IRC § 988(e)(3).

<sup>25</sup> IRC § 165(c) limits the loss deduction for individuals to losses incurred in a trade or business, losses incurred in any transaction entered into for profit, and casualty losses. See also H. Rep. 105-148, 105th Cong., 1st Sess., at 263, 447-448 (1997).

<sup>26</sup> See generally IRC §§ 988(a)(3); 911(d)(3). The term "tax home" has the same meaning which it has for purposes of IRC § 162(a)(2) (relating to travel expenses away from home) and is considered to be located at an individual's regular or principal (if more than one regular) place of business or, if the individual has no regular or principal place of business because of the nature of the business, then at his or her regular place of abode in a real and substantial sense. IRC § 911(d)(3); Treas. Reg. § 1.911-2(b).

<sup>27</sup> The IRS does not have official exchange rates and generally accepts any posted exchange rate that is used consistently. The IRS's website refers to three government and three external resources for currency exchange rates. See IRS, *Foreign Currency and Currency Exchange Rates*, <http://www.irs.gov/businesses/small/article/0,,id=130524,00.html> (last visited Sept. 25, 2011).

Additionally, for many U.S. taxpayers abroad, the disposition of any foreign currency resulting in a gain of \$200 or more is a recognition event, meaning that many of those individuals' routine transactions (for example, paying rent) in foreign currency can give rise to taxable gain.<sup>28</sup> Because exchange gains in excess of \$200 are taxable while exchange losses cannot offset gains on personal transactions, determining certain individuals' U.S. tax liabilities in dollars (when their financial results are calculated in a foreign currency) can yield distorted results, especially in years of currency volatility.<sup>29</sup>

The IRC § 988(e) exclusion passed in 1997 (as part of the Taxpayer Relief Act of 1997) was intended to simplify reporting by individual taxpayers and eliminate an individual's obligation to compute and report gains arising from exchanges of currency that are *de minimis* in amount and are associated with personal transactions.<sup>30</sup> However, the legislation did not achieve that goal. To determine whether the gain from any disposition of nonfunctional currency is \$200 or less and therefore is not recognized under the exclusion, individual taxpayers must first compute the gain on each transaction separately. These multiple computations are burdensome for taxpayers as well as being difficult and time-consuming for IRS auditors to verify. Without allowing individual U.S. taxpayers to elect the currency of their country of residence as the functional currency, the goal of eliminating multiple foreign exchange computations associated with personal, nonbusiness activities cannot be practically achieved.

From a tax administration perspective, these rules require IRS audits to verify multiple exchange rate computations for personal transactions and substantiate spot exchange rates at the time the transaction took place, which could be very labor-intensive and inefficient. The sheer complexity of converting every personal expenditure into U.S. currency makes it all but impossible for the IRS to undertake any reasonable or effective compliance initiative in this area.

<sup>28</sup> For example, when a U.S. citizen residing in Canada receives a monthly salary of CA\$3000 on July 15 of a taxable year, she must first convert CA\$3000 into U.S. dollars at the spot rate of .95 \$ for CA\$ on the 15th of July, meaning that each CA\$ has a basis of 95 U.S. cents. Then when she pays rent of CA\$1500 on August 1 of a taxable year, it is treated as a disposition of foreign currency (assuming that the taxpayer can determine the basis of the exact amount in foreign currency). If the exchange rate on August 1 is \$1.1 per CA\$1, she realizes and must recognize a taxable exchange gain of \$225 as the difference between the U.S. dollar basis in the currency (CA\$1500 \* .95 = \$1425) and the U.S. dollar amount realized (CA\$1500 \* 1.1 = \$1650). However, if the change in exchange rates results in a loss, such a loss is personal and therefore nondeductible.

<sup>29</sup> For some taxpayers, gain or loss can arise simply because of changes in foreign currency values, which may not represent a net gain or loss for the taxpayer. These gains are taxable, while losses on these transactions are nondeductible because the transactions are personal.

<sup>30</sup> See Pub. L. No. 105-34, 111 Stat. 788 (1997). See also H. Rep. 105-148, 105th Cong., 1st Sess., at 263, 447-448 (1997) ("Reasons for Change. An individual who lives or travels abroad generally cannot use U.S. dollars to make all of the purchases incident to daily life. If an individual must treat foreign currency in this instance as property giving rise to U.S.-dollar income or loss every time the individual, in effect, barter the foreign currency for goods or services, the U.S. individual living in or visiting a foreign country will have a significant administrative burden that may bear little or no relation to whether U.S.-dollar measured income has increased or decreased. The Committee believes that individuals should be given relief from the requirement to keep track of exchange gains on a transaction-by-transaction basis in *de minimis* cases.").

As a result, current functional currency rules applicable to individual U.S. taxpayers abroad discourage voluntary compliance, are difficult to administer, and unnecessarily burden both taxpayers and the IRS.<sup>31</sup>

## EXPLANATION OF RECOMMENDATION

The National Taxpayer Advocate recommends applying rules similar to the QBU rules to individuals with respect to personal activities occurring in the foreign country in which a U.S. person is a *bona fide* resident (as defined in IRC § 911(d)(1)).<sup>32</sup> Under this legislative proposal, individual U.S. taxpayers resident in a foreign country would be permitted to elect the local currency as their functional currency with respect to certain activities associated with their residence in that country (e.g., activities of a qualified residence unit or QRU). Qualified QRU activities would include most personal, nonbusiness transactions associated with a taxpayer's *bona fide* residence in a foreign country. Permitting individual taxpayers to elect a foreign currency as a functional currency of the QRU would allow them to receive and spend the foreign currency on routine personal transactions without potentially triggering gain on each transaction. Taxpayers also could aggregate all their transactions in a foreign currency and use a single exchange rate (generally, the average rate for the year) to translate their income, including the realized currency gain (if any), annually.

The proposed legislative change would not alter the current treatment of certain investment and other financial transactions of individual U.S. taxpayers abroad set forth in IRC § 988.<sup>33</sup> However, there are certain policy concerns for Congress' consideration. Under current rules, investments of U.S. taxpayers abroad, such as a purchase and disposition of a primary residence or retirement savings, may result in a gain which may not represent a net gain for the taxpayer.<sup>34</sup> For example, fluctuations in exchange rates can lead to instances in which a taxpayer realizes taxable gain on the sale of a residence, but may not offset

<sup>31</sup> Groups of American citizens abroad have long advocated for the change in the functional currency rules for *bona fide* U.S. residents abroad. See, e.g., *The Burdens Imposed by the Current Federal Income Tax System and the Need for Reform, Hearing Before the H. Comm. on Ways and Means, 112th Cong.* (statement of American Citizens Abroad (ACA), the Association of Americans Resident Overseas (AARO), and the Federation of American Women's Clubs, Inc. (FAWCO)); The Association of Americans Resident Overseas, *Legislative Proposals for Tax Reform Concerning U.S. Citizens Residing Abroad*, <http://www.aaro.org/proposals-for-tax-reform> (last visited Sept. 25, 2011). See also Overseas Americans Week 2011, <http://www.overseasamericansweek.com> (last visited Sept. 25, 2011).

<sup>32</sup> This change would not add complexity because current law requires these individuals to satisfy the *bona fide* residence test or the physical presence test to claim the foreign earned income exclusion. To qualify for foreign earned income exclusion and foreign housing exclusion or deduction, a U.S. citizen or resident alien (for tax purposes) must have a tax home in a foreign country, and either be a *bona fide* resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year (*bona fide* residence test), or be present in a foreign country or countries during at least 330 full days in any period of 12 consecutive months (physical presence test). IRC § 911(d).

<sup>33</sup> See, e.g., legislative history underlying IRC § 988 which indicates that § 988 rules were designed to address, *inter alia*, "opportunities for tax-motivated transactions involving certain financial assets or liabilities that are denominated in a nonfunctional currency." See S. Rep. No. 313, 99th Cong., 2d Sess., at 450 (1986); General Explanation of the Tax Reform Act of 1986 (Pub. L. No. 99-514) JCS-10-87, Pt. 3, Title XII, at 1091 (1987).

<sup>34</sup> From a taxpayers' perspective, currency gains as a result of certain investment transactions are "phantom" (i.e., not representing an actual economic gain). For example, a married couple, H and W, are U.S. citizens and *bona fide* residents of country A. In taxable year (TY) 2009, a married couple had to liquidate some assets because of a family medical emergency. The couple decided to sell 100 shares of XYZ Company stock that they purchased for LC 10,000 in September 2000. Given the exchange rate on the date of purchase of \$0.865 to LC 1, the stock was worth \$8,650. The couple sells the stock in March 2010 for LC 9,600, which is worth approximately \$14,650 (at the exchange rate of \$1.525 to LC 1), resulting in an actual or economic loss of LC 400, and a taxable gain of \$6,000 for U.S. tax purposes. They do not exchange the funds into dollars or any other currency.

losses on a related mortgage under the personal loss disallowance rules.<sup>35</sup> The National Taxpayer Advocate recommends that Congress take into account these concerns when considering the legislation for “benign” U.S. taxpayers residing abroad who do not invest in or trade foreign currency or move abroad to exempt gains and losses from such investment activities resulting from currency fluctuations.<sup>36</sup>

Under this proposal, we recommend that Congress continue to grant the IRS broad regulatory authority in this area and, if a new statutory provision is enacted, further authorize the Secretary to prescribe regulations to address offsetting gains and losses on personal mortgages and related foreign-currency denominated mortgages.<sup>37</sup>

Allowing an individual U.S. taxpayer living abroad the option of using the currency of the country of residence for tax purposes would facilitate both compliance with and administration of U.S. tax laws, and would produce results based on economic reality rather than the arbitrary movement of exchange rates. This legislative change will simplify record-keeping and computations, decrease distortions of economic gain or loss for tax purposes, and therefore increase voluntary compliance and public trust in the fairness of the U.S. tax system.

<sup>35</sup> See IRC § 165(c); see also *Quijano v. U.S.*, 93 F.3d 26 (1st Cir. 1996), and Rev. Rul. 90-79, 1990-2 C.B. 187 (both holding that an individual U.S. citizen residing in a foreign country could not offset the gain realized from the sale of a personal residence with a loss realized from the repayment of a nonfunctional currency denominated mortgage loan used to finance the purchase of the residence). Please note that the instances in which non-economic gains are taxable only occur in specific cases, e.g., the sale of a leveraged personal asset or the sale of investments to fund personal expenses.

<sup>36</sup> For example, an individual U.S. taxpayer living in Switzerland could generally determine his wages and deductible expenses in Swiss francs and translate these items at the average exchange rate for the year. However, if that individual invested in Swiss franc-denominated bonds or other financial instruments, IRC § 988 would continue to apply to such investments. A difficult question would be how to treat Swiss francs invested in checking and savings accounts. A U.S. taxpayer will realize real economic currency gains and losses from such accounts and the amounts deposited may be substantial. One approach would be to establish a threshold at which currency movements on amounts deposited in a bank would be taxable.

<sup>37</sup> See IRC § 989(c). The legislative recommendation would not necessarily reverse the result in *Quijano* and Rev. Rul. 90-79. See *Quijano*, 93 F.3d 26 (1st Cir. 1996); Rev. Rul. 90-79, 1990-2 C.B. 187.

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## Codify the Authority of the National Taxpayer Advocate to File *Amicus* Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives

### PROBLEM

The National Taxpayer Advocate is required to assist taxpayers in resolving problems with the IRS, to identify areas in which taxpayers have frequent problems or that are the frequent subject of litigation, and to identify administrative and legislative solutions to reduce controversy and mitigate such problems.<sup>1</sup> Despite these mandates, the mission of the Office of the Taxpayer Advocate would be advanced by additional statutory authority in three areas: *amicus curiae* briefs pertaining to taxpayer rights; the administrative rulemaking process; and the Taxpayer Advocate Directive.

#### Authority to File *Amicus Curiae* Briefs Pertaining to Taxpayer Rights

The National Taxpayer Advocate is not authorized to participate in litigation.<sup>2</sup> While the conduct of relevant trials themselves may be best left to trial lawyers equipped to advocate zealously on behalf of individual clients, precedential issues of interest to numerous taxpayers may come before the judiciary with no one representing the rights of taxpayers in general.

#### Authority to Comment on Regulations and the Requirement of IRS Response

Another form of problem resolution is the drafting of guidance on controversial or complex issues. The IRS often issues rules and regulations to illuminate tax law complexities. In the case of published guidance, the IRS Office of Chief Counsel and the Department of the Treasury prepare and circulate drafts internally for cross-divisional commentary.<sup>3</sup> When the IRS and Treasury promulgate tax regulations, the public has an opportunity to comment at a hearing and in writing prior to finalization of the regulations.<sup>4</sup> These internal and external processes may yield productive commentary, especially from interested parties, industry associations, institutional constituencies, or the professional bar. Although

<sup>1</sup> Internal Revenue Code (IRC) § 7803(c)(2)(A)(i)-(iv).

<sup>2</sup> See 28 U.S.C. § 516 (“Except as otherwise authorized by law, the conduct of litigation in which the United States, an agency, or officer thereof is a party, or is interested, and securing evidence therefor, is reserved to officers of the Department of Justice”); 5 U.S.C. § 3106 (“Except as otherwise authorized by law, the head of an Executive department or military department may not employ an attorney or counsel for the conduct of litigation in which the United States, an agency, or employee thereof is a party”); IRC § 7452 (indicating that the Secretary of the Treasury “shall be represented by the Chief Counsel”).

<sup>3</sup> IRC § 7803(b)(2) (indicating that the Chief Counsel is the chief law officer for the IRS); see *generally* Treas. Reg. § 601.601.

<sup>4</sup> Generally, the Admin. Proc. Act (APA) requires public notice and opportunity to comment on regulatory rule-making except for, *inter alia*, interpretative rules. 5 U.S.C. § 553. According to IRS Chief Counsel Directives Man. (CCDM) 32.1.1.2.6(1) (Sept. 23, 2011): “Most IRS/Treasury regulations are considered interpretative because the underlying statute implemented by the regulation contains the necessary legal authority for the action taken and any effect of the regulation flows directly from that statute.” Nevertheless, “the Service usually solicits public comment when it promulgates a rule.” CCDM 32.1.5.4.7.5.1(3) (Sept. 30, 2011). According to an academic commentator, “the opposite is true. . . . under general principles of administrative law, it is difficult to characterize most Treasury regulations as anything other than legislative rules subject to the notice-and-comment rulemaking requirements of APA § 553(b) and (c) and ineligible for the interpretative rule, procedural rule, or good cause exceptions from those procedures.” Kristin E. Hickman, *A Problem of Remedy: Responding to Treasury’s (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 76 GEO. WASH. L. REV. 1153, 1158 (2008).

the National Taxpayer Advocate is charged with representing the interests of individuals, including low income taxpayers, there is no statutory requirement that the IRS address the National Taxpayer Advocate's comments before publishing final regulations. In the case of the Small Business Administration (SBA), the Chief Counsel for Advocacy has statutory authority to represent the interests of small businesses by appearing as *amicus curiae*<sup>5</sup> and providing comments that the IRS must consider before publishing any final regulation.<sup>6</sup>

### The Authority to Issue a Taxpayer Advocate Directive

In the course of assisting taxpayers in resolving problems or identifying areas in which taxpayers have problems in dealing with the IRS, the National Taxpayer Advocate from time to time confronts procedural obstacles. In such cases, the Commissioner of Internal Revenue has delegated to the National Taxpayer Advocate the authority to issue Taxpayer Advocate Directives that direct IRS units to change procedures "to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers."<sup>7</sup> However, the IRS may not comply with or even respond to a Taxpayer Advocate Directive because it comes not under a statute but merely a delegated power that the Commissioner could revoke. In practice, the Commissioner or Deputy Commissioner, along with the National Taxpayer Advocate, may rescind or modify a Taxpayer Advocate Directive.<sup>8</sup>

## EXAMPLES

### Innocent Spouse Relief

In 2000, two years after a substantial amendment of the innocent spouse statute, which generally affords relief from the tax liability of a joint filer,<sup>9</sup> the IRS prescribed applicable procedures through sub-regulatory guidance.<sup>10</sup> In 2001, the IRS incorporated a two-year limit on claims for equitable relief into proposed regulations,<sup>11</sup> duly finalized the next year after a notice and comment procedure.<sup>12</sup> No comments on this limitation were received or entered the published record.

After the regulation took effect, it became evident to innocent spouses and their representatives that the limitation impeded otherwise meritorious claims. In 2006 and 2010, the National Taxpayer Advocate called attention to the issue through published recommenda-

<sup>5</sup> 5 U.S.C. § 612(b).

<sup>6</sup> IRC § 7805(f).

<sup>7</sup> Delegation Order 13-3 (formerly DO-250, Rev. 1), *reprinted as* IRM 1.2.50.4 (Jan. 17, 2001); see also IRM 13.2.1.6 (July 16, 2009).

<sup>8</sup> Delegation Order 13-3 (formerly DO-250, Rev. 1), *reprinted as* IRM 1.2.50.4 (Jan. 17, 2001).

<sup>9</sup> See IRC § 6015 (relating to relief from joint and several liability) *added by* Pub. L. No. 105-206, § 3201 (1998).

<sup>10</sup> See Rev. Proc. 2000-15, 2000-1 C.B. 447, *superseded by* Rev. Proc. 2003-61, 2003-2 C.B. 296 (containing parallel provisions).

<sup>11</sup> Relief from Joint and Several Liability, 66 Fed. Reg. 3,888 (proposed Jan. 17, 2001).

<sup>12</sup> See Treas. Reg. § 1.6015-5(b)(1), 67 Fed. Reg. 47,294 (July 18, 2002).

tions to remove the regulatory period of limitation.<sup>13</sup> Meanwhile, the Tax Court invalidated the regulatory limitation, only to spawn protracted litigation in multiple circuits of the Courts of Appeals, which reversed the Tax Court and upheld the validity of the regulation.<sup>14</sup> In the 2010 Annual Report to Congress, the National Taxpayer Advocate published a comprehensive analysis of the legislative history for Internal Revenue Code (IRC) § 6015(f), which could not be submitted as an *amicus* brief in pending appellate litigation under present law.<sup>15</sup> After urging by numerous Senators and Representatives,<sup>16</sup> the Commissioner reviewed the regulation and decided to rescind the two-year rule.<sup>17</sup>

### Timely Mailing and Filing

In general, timely mailing by taxpayers constitutes timely filing with the IRS.<sup>18</sup> Specifically, a registered or certified mail receipt is *prima facie* evidence of delivery on the postmark date.<sup>19</sup> Over the years, a split in the circuits has developed concerning this rule. Some circuits have allowed taxpayers to present evidence of mailing other than a registered or certified mail receipt.<sup>20</sup> Other circuits have excluded extrinsic evidence.<sup>21</sup> In 2004, the IRS issued a proposed regulation stating that a registered or certified mail receipt is the exclusive *prima facie* evidence, other than direct proof of actual delivery.<sup>22</sup> The National Taxpayer Advocate informally offered oral and written comments that the statute supplements, rather than supplants, a taxpayer's right to present evidence; limiting the presumption to registered or certified mail creates a foot-fault when some other mailings may have been timely. Without acknowledging the National Taxpayer Advocate's comments in the preamble, the IRS finalized the regulation in 2011.<sup>23</sup>

### Adjustment of Accounts for Victims of Return Preparer Fraud

The National Taxpayer Advocate issued a Proposed Taxpayer Advocate Directive to the Commissioner of the IRS Wage and Investment (W&I) operating division, ordering him to issue guidance and implement a procedure for adjusting the accounts of taxpayers who had

<sup>13</sup> National Taxpayer Advocate 2006 Annual Report to Congress 540 (Legislative Recommendation: *Eliminate the Two-Year Limitation Period for Taxpayers Seeking Equitable Relief Under IRC § 6015 or IRC § 66*); National Taxpayer Advocate 2010 Annual Report to Congress 377 (Legislative Recommendation: *Allow Taxpayers to Request Equitable Relief Under Internal Revenue Code Section 6015(f) or 66(c) at any Time Before Expiration of the Period of Limitations on Collection and to Raise Innocent Spouse Relief as a Defense in Collection Actions*).

<sup>14</sup> See *Lantz v. Comm'r*, 132 T.C. 131 (2009), *rev'd and remanded*, 607 F.3d 479 (7th Cir. 2010); *Mannella v. Comm'r*, 132 T.C. 196 (2009), *rev'd*, 631 F.3d 115 (3d Cir. 2011); *Jones v. Comm'r*, T.C. Docket No. 17359-08, *rev'd and remanded*, 642 F.3d 459 (4th Cir. 2011).

<sup>15</sup> National Taxpayer Advocate 2010 Annual Report to Congress vol. 2, 1 (Research Study: *Unlimit Innocent Spouse Equitable Relief*).

<sup>16</sup> See 2011 TNT 75-27, 75-28 (Apr. 19, 2011).

<sup>17</sup> IRS News Release, *Two-Year Limit No Longer Applies to Many Innocent Spouse Requests*, IR-2011-80 (July 25, 2011).

<sup>18</sup> IRC § 7502(a).

<sup>19</sup> IRC § 7502(c); Treas. Reg. § 301.7502-1(c)(2).

<sup>20</sup> See, e.g., *Estate of Wood v. Comm'r*, 909 F.2d 1155 (8th Cir. 1990), *aff'g* 92 T.C. 793 (1989), *action on dec.*, 1991-024 (Oct. 22, 1991).

<sup>21</sup> See, e.g., *Deutsch v. Comm'r*, 599 F.2d 44 (2d Cir. 1979), *cert. denied*, 444 U.S. 1015 (1980).

<sup>22</sup> *Timely Mailing Treated as Timely Filing*, 69 Fed. Reg. 56,377 (proposed Sept. 21, 2004).

<sup>23</sup> T.D. 9543, 76 Fed. Reg. 52,561 (Aug. 23, 2011). It is currently the practice of the IRS to discuss substantive external comments in the preamble. Many internal stakeholders, including the National Taxpayer Advocate, may offer comments, none of which are discussed in the preamble. See CCDM 32.1.8.3(1) (Aug. 11, 2004).

been victimized by return preparers.<sup>24</sup> The W&I Commissioner failed to respond timely to the Proposed Taxpayer Advocate Directive, and the problem remains unresolved.<sup>25</sup>

## RECOMMENDATION

To enhance the independence of the Office of the Taxpayer Advocate and ensure that the rights of taxpayers, including the most vulnerable and unrepresented, are considered and protected in tax administration, regulations, and litigation, the National Taxpayer Advocate recommends that Congress:<sup>26</sup>

1. Authorize the National Taxpayer Advocate to submit *amicus curiae* briefs in federal appellate litigation on matters relating to the protection of taxpayer rights that the National Taxpayer Advocate has identified as concerns in her Annual Reports to Congress.
2. Require the IRS to submit proposed or temporary regulations pre-publication to the National Taxpayer Advocate for comment within a reasonable time, and address those comments in the preamble to final regulations.
3. Authorize the National Taxpayer Advocate to appoint an independent counsel who reports directly to the National Taxpayer Advocate, to provide independent legal advice, including submission of *amicus curiae* briefs and comments on proposed or temporary regulations.
4. Grant to the National Taxpayer Advocate nondelegable authority to issue a Taxpayer Advocate Directive with respect to any IRS program, proposed program, action, or failure to act that may create a significant hardship for a segment of the taxpayer population or for taxpayers at large, and require that, to object to a directive, the IRS would have to respond timely in writing.<sup>27</sup>
5. Amend IRC § 7811 to require the IRS to raise its objections to a Taxpayer Assistance Order (*i.e.*, appeal the Order) issued by the National Taxpayer Advocate by responding in writing within a reasonable time, as established by the National Taxpayer Advocate in the Order.

## PRESENT LAW

Congress established the position of Chief Counsel, a Senate-confirmed official who reports to the Treasury General Counsel regarding tax policy, but to the Commissioner of Internal

<sup>24</sup> Proposed TAD 2011-1 (June 13, 2011). See also Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS, supra*; Legislative Recommendation: *Assessment of Civil Penalties Against Preparers of Fraudulent Returns, supra*.

<sup>25</sup> The Dep. Comm'r (Services and Enforcement) wrote to the National Taxpayer Advocate on Sept. 2, 2011, that the IRS is "in the process of developing procedures to adjust taxpayers' accounts where the taxpayer never received a refund or portion of a refund due to preparer fraud and appropriate documentation has been submitted."

<sup>26</sup> Previously, the National Taxpayer Advocate has recommended legislation for *amicus* briefs and independent counsel. See National Taxpayer Advocate 2002 Annual Report to Congress 198-215 (Legislative Recommendation: *Office of the Taxpayer Advocate*).

<sup>27</sup> Previously, a recommendation to codify Taxpayer Advocate Directives appeared in National Taxpayer Advocate 2002 Annual Report to Congress 198.

Revenue and the Treasury General Counsel with respect to legal advice or interpretation of the tax law not relating solely to tax policy.<sup>28</sup> The Office of Chief Counsel is the legal advisor to the IRS, furnishing legal opinions, preparing Treasury Regulations, representing the IRS in the United States Tax Court, and preparing recommendations for the Department of Justice regarding which civil tax litigation to pursue.<sup>29</sup>

The IRS issues rules and regulations,<sup>30</sup> which the Office of Chief Counsel circulates internally for comment (to the National Taxpayer Advocate as well as other IRS functions)<sup>31</sup> prior to submission to Treasury for review and approval. The IRS publishes proposed regulations in the *Federal Register*, creating an opportunity for public comment. The tax law specifically requires that after publication, the IRS must submit proposed and temporary regulations to the Chief Counsel for Advocacy of the SBA for comment, and the Chief Counsel for Advocacy must provide comments, if any, within four weeks; the IRS is then required to respond to the comments in the preamble to the final regulation.<sup>32</sup> After reviewing comments, the IRS finalizes regulations for incorporation into the Code of Federal Regulations.

Chief Counsel attorneys are assigned to the Office of the Special Counsel (National Taxpayer Advocate Program).<sup>33</sup> In addition, the Office of the Taxpayer Advocate has hired lawyers who do not report to the Chief Counsel.<sup>34</sup> These lawyers prepare legislative recommendations for the National Taxpayer Advocate, render advice to the National Taxpayer Advocate in cases in which TAS is advocating for the taxpayer vis-à-vis the IRS, represent the National Taxpayer Advocate in meetings with the Office of Chief Counsel and the IRS, and assist in drafting Reports to Congress and congressional testimony.

The SBA's Chief Counsel for Advocacy has statutory authority to submit *amicus* briefs.<sup>35</sup> That Counsel's primary responsibility is to oversee federal compliance with the Regulatory Flexibility Act, which seeks to forestall any rules that impose unnecessary burdens on the public.<sup>36</sup> A small business or other entity that is adversely affected or aggrieved by final government action may be entitled to judicial review, which can result in remand of a regulation for corrective action by the issuing agency and deferral of enforcement against small entities.<sup>37</sup> In any such litigation, the Chief Counsel for Advocacy is authorized to present

<sup>28</sup> IRC § 7803(b)(3).

<sup>29</sup> IRC § 7803(b)(2).

<sup>30</sup> IRC § 7805(a).

<sup>31</sup> CCDM 32.1.6.7.2(2) (Aug. 11, 2004).

<sup>32</sup> IRC § 7805(f); see also *Jt. Comm. on Tax'n, Description of Small Business Tax Incentive Act of 1990*, JCX-40-90 (Oct. 15, 1990) 5.

<sup>33</sup> IRC § 7803(b)(4).

<sup>34</sup> See H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess., at 216 (June 24, 1998) (discussed *infra*). Other IRS lawyers outside of the Office of Chief Counsel include those in the Office of Professional Responsibility and estate tax lawyers in the SB/SE Operating Division.

<sup>35</sup> 5 U.S.C. § 612(b).

<sup>36</sup> Pub. L. No. 96-354, § 2(a)(1), 94 Stat. 1164, 1170 (Sept. 19, 1980) (findings codified at 5 U.S.C. § 601); 5 U.S.C. § 612(a) (duties of SBA Chief Counsel for Advocacy). Like the National Taxpayer Advocate, the Chief Counsel for Advocacy submits reports to Congress at least annually. *Id.*

<sup>37</sup> 5 U.S.C. § 611.

views regarding compliance with the Act, the adequacy of the rule-making record with respect to small entities, and the effect of rules on small entities.<sup>38</sup> While the Department of Justice initially questioned the constitutionality of this authority, such questions have subsided, and more recently, the Chief Counsel for Advocacy has filed *amicus* briefs judiciously and successfully.<sup>39</sup>

As cited above, a delegation order and internal guidance govern Taxpayer Advocate Directives. Where a previous request to change a process or grant relief has been to no avail, the Commissioner of Internal Revenue has delegated authority to the National Taxpayer Advocate (but not her delegate) to issue a Taxpayer Advocate Directive to protect taxpayer rights, ensure equitable treatment, or provide an essential service.<sup>40</sup> An IRS division commissioner or other executive may appeal a Taxpayer Advocate Directive to the Deputy Commissioner (Services and Enforcement).<sup>41</sup>

By contrast, the Internal Revenue Code explicitly authorizes the National Taxpayer Advocate (or her delegate) to issue a Taxpayer Assistance Order if a taxpayer may suffer significant hardship because of the IRS's manner of tax administration.<sup>42</sup> A Taxpayer Assistance Order may require the IRS to release levied property or to cease, take, or refrain from any action under specified law.<sup>43</sup> The Commissioner or Deputy Commissioner may rescind or modify a Taxpayer Assistance Order upon delivering a written explanation to the National Taxpayer Advocate.<sup>44</sup> The National Taxpayer Advocate is authorized by statute to establish the timeframes within which such actions or responses must occur.<sup>45</sup>

## REASONS FOR CHANGE

### Authority to File *Amicus Curiae* Briefs Pertaining to Taxpayer Rights

As in the case of the SBA Chief Counsel for Advocacy, there is good reason to allow the federal judiciary to hear the perspective of the National Taxpayer Advocate — an independent advocate for taxpayer rights and fair tax administration. By its nature, this perspective may diverge from that of the IRS, and would not necessarily be endorsed by the actual taxpayers who are embroiled in specific litigation, where circumstances rather than principles

<sup>38</sup> 5 U.S.C. § 612(b) (authorizing *amicus* briefs).

<sup>39</sup> At one time, the Department of Justice opposed an SBA brief on the ground that the provision granting the Chief Counsel for Advocacy the authority to act as *amicus curiae* violated the Constitution. This led to withdrawal of the brief, but the Congressional Research Service (CRS) later concluded the authority was constitutional. H. R. Rept. No. 104-49, Appdx. D at 3-4 (Feb. 23, 1995) (discussing the opposition to the brief, but attaching a CRS report concluding that the *amicus* authority was constitutional). The Chief Counsel for Advocacy has since filed at least five more *amicus* briefs, which appear to have been successful in prompting Government concessions without challenge on constitutional grounds. See SBA, *Background Paper on the Office of Advocacy 2001-2008* (Oct. 2008) 40-41.

<sup>40</sup> IRM 13.2.1.6(3) (July 16, 2009).

<sup>41</sup> IRM 13.2.1.6.2 (July 16, 2009).

<sup>42</sup> IRC § 7811(a), (f).

<sup>43</sup> IRC § 7811(b).

<sup>44</sup> IRC § 7811(c).

<sup>45</sup> IRC § 7811(b).

may induce settlement. Precisely for this reason, Congress has seen fit to establish the Office of the Taxpayer Advocate, whose mandate could be facilitated by an independent counsel function extending to the submission of *amicus* briefs on behalf of the National Taxpayer Advocate in precedential cases in which taxpayer rights might not otherwise be represented.

#### **Authority to Comment on Regulations and the Requirement of IRS Response**

Also as in the case of the SBA Chief Counsel for Advocacy, there is good reason to mandate review of proposed and temporary IRS regulations. In general, public comment improves rule-making by allowing recommendations and observations from experts with knowledge outside of government. A robust comment process justifies judicial deference to regulations that have benefited from external review.<sup>46</sup> Where interested parties, industry associations, or tax law professionals offer analysis of proposed regulations, the notice-and-comment process is successful. On the other hand, some taxpayer interests are not represented by sophisticated tax professionals. In the case of small businesses, Congress recognized this need by legislatively mandating regulatory review on their behalf by a counsel dedicated to this function. The rights of individual taxpayers, including low income taxpayers, may fall in a gap in regulatory review. While the National Taxpayer Advocate is often included in pre-publication circulation of proposed or temporary regulations, the IRS is not required to address her comments in the published preambles to final regulations. The National Taxpayer Advocate believes that tax administration would be improved if the public knew what her concerns were with respect to regulations and how the IRS addressed those concerns.

#### **The Authority to Issue a Taxpayer Advocate Directive**

Finally, the National Taxpayer Advocate's ability to create systemic change remains incomplete without statutory authority to issue Taxpayer Advocate Directives. The judicial and regulatory recommendations above complement existing authority for legislative proposals. While current law guarantees protection of taxpayer rights under a Taxpayer Assistance Order in an individual case, no law ensures that a Taxpayer Advocate Directive redressing a flawed process — which could harm entire taxpayer populations — will be honored, timely acted upon, or even acknowledged by the IRS.

### **EXPLANATION OF RECOMMENDATION**

The National Taxpayer Advocate, who is mandated to report annually to Congress on frequently litigated tax issues and serious taxpayer problems, may comment on issues developing in the courts, but has no authority to submit her independent perspective to the

<sup>46</sup> See *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 173-74 (2007) (citation omitted) (stating “where the agency uses full notice-and-comment procedures to promulgate a rule, . . . then a court ordinarily assumes that Congress intended it to defer to the agency’s determination.”).

judiciary.<sup>47</sup> Likewise, the National Taxpayer Advocate may identify issues and offer comments to the Office of Chief Counsel on taxpayer rights during the drafting of a regulation, but has no statutorily mandated process for review on behalf of individual taxpayers. If the Office of Chief Counsel circulates proposed rules through the IRS, the Special Counsel (National Taxpayer Advocate Program) coordinates the distribution of drafts to the National Taxpayer Advocate and her subject matter experts. Although the IRS's practice is to circulate all guidance to the National Taxpayer Advocate for comment prior to publication,<sup>48</sup> the law should provide for mandated review by the National Taxpayer Advocate. As with the review process for regulations submitted to the SBA Chief Counsel for Advocacy,<sup>49</sup> the IRS should be required to respond to TAS comments in the preamble to the final regulation.

When Congress reorganized the IRS in 1998, the Senate passed legislation providing for counsel to the National Taxpayer Advocate to be appointed by and report directly to the National Taxpayer Advocate and to operate within the Office of the Taxpayer Advocate.<sup>50</sup> In sponsoring this provision, Senator Charles Grassley (R-Iowa) offered the following rationale:

The purpose of doing this is to give the Taxpayer Advocate ready access to legal opinions and legal judgments. Currently, the Taxpayer Advocate must put requests into the Office of Chief Counsel.

In order to make the Taxpayer Advocate more independent, which is what this bill does, it logically follows that the Taxpayer Advocate should have its own legal counsel. This will guarantee it fast, confidential legal advice to help those taxpayers in greatest need. Because it is the taxpayers in greatest need who go to the Taxpayer Advocate.<sup>51</sup>

This provision was eliminated in the conference agreement. Still, the conference report noted that the "conferees intend that the National Taxpayer Advocate be able to hire and consult counsel as appropriate."<sup>52</sup>

Although the National Taxpayer Advocate has hired lawyers, she does not have the authority to file *amicus* briefs. While the National Taxpayer Advocate, or her attorneys, may comment informally on rule-making from time to time, the IRS is not required by law to notify the National Taxpayer Advocate of proposed or temporary regulations or to respond to her comments before publishing final regulations. By statutorily requiring the IRS (1) to provide the National Taxpayer Advocate with proposed and temporary regulations prior to

<sup>47</sup> See Program Manager Tech. Assistance 00566, *Authority for the National Taxpayer Advocate to File Amicus Briefs with the Courts of the United States* (Oct. 2, 2002).

<sup>48</sup> See CCDM 32.1.6.7.2(2) (Aug. 11, 2004).

<sup>49</sup> IRC § 7805(f)(2).

<sup>50</sup> H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess., at 215 (June 24, 1998).

<sup>51</sup> 144 CONG. REC. S4460 (May 7, 1998) (statement of Sen. Grassley).

<sup>52</sup> H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess., at 216 (June 24, 1998).

publication, and (2) to formally address the National Taxpayer Advocate's concerns in the preamble to final regulations, Congress and the taxpaying public can confirm that taxpayer rights concerns are addressed in the rulemaking process.

Further, in a case where the National Taxpayer Advocate adopts a position that diverges from that of the IRS, the official position of Chief Counsel attorneys is that of the IRS.<sup>53</sup> Because the National Taxpayer Advocate is authorized by law to advocate for change, which often is in conflict with the official position of the IRS, this reporting structure can impair a Chief Counsel attorney's ability to zealously represent the interests of the National Taxpayer Advocate. Moreover, a Chief Counsel attorney would not be able to submit an *amicus curiae* brief on behalf of the National Taxpayer Advocate if such brief were in conflict with the position of the IRS. Thus, providing the National Taxpayer Advocate the statutory authority to appoint an independent Counsel to the National Taxpayer Advocate, reporting to the National Taxpayer Advocate and not to the Chief Counsel, would help ensure that the National Taxpayer Advocate's concerns about protection of taxpayer rights are considered and represented in the regulatory and judicial arenas.

In addition, a codified Taxpayer Advocate Directive process would enhance the National Taxpayer Advocate's ability to make systemic changes. To align the proposed authority with current Taxpayer Assistance Order law,<sup>54</sup> the recommended legislation would make the Commissioner (but not his delegate) the final arbiter when an IRS office appeals a directive. An appeal should contain a written explanation to the National Taxpayer Advocate and the Commissioner that facilitates a full and fair hearing of the issues. If an office does not appeal but simply does not respond in writing to the National Taxpayer Advocate within a reasonable time outlined in the Taxpayer Advocate Directive, then the proposed legislation would deem the IRS to have consented to making the requested systemic changes. A parallel default clause should be enacted within existing IRC § 7811 regarding Taxpayer Assistance Orders.

As under current IRC § 7811, the Commissioner could rescind or modify a Taxpayer Advocate Directive upon delivering a written explanation to the National Taxpayer Advocate. A report on rescissions by the Commissioner should be added to the National Taxpayer Advocate's annual reporting mandates.<sup>55</sup>

Together, the three components of this recommendation will enable the Office of the Taxpayer Advocate to more effectively resolve issues that are frequently litigated, further protect taxpayer rights, and deal with other recurring problems.

<sup>53</sup> See IRC § 7803(b)(4) (relating to personnel who report to the Chief Counsel).

<sup>54</sup> IRC § 7811.

<sup>55</sup> On annual reporting, see IRC § 7803(c)(2)(B).

LR  
#13**Appoint an IRS Historian****PROBLEM**

From time to time, the IRS undertakes initiatives to improve tax administration, with both successes and failures. No unit of the IRS is charged with recording these events, so any opportunity to learn from them in the future is lost. A leading academic tax historian has noted that while Publication 1694, *IRS Historical Fact Book: A Chronology, 1646-1992*, memorializes a tax timeline, “[w]e do not have a scholarly history of the Internal Revenue Service.”<sup>1</sup> More dramatically, a critic has testified before the Senate Finance Committee that “the IRS shreds its paper trail, which means there is no history, no evidence, and ultimately no accountability.”<sup>2</sup> A record of IRS accomplishments is lost along with historical facts.

**EXAMPLES**

In 1984 and 1985, the IRS’s effort to transfer its massive workload to an ambitious new computer system overwhelmed management and technology. Harried front-line personnel discarded thousands of taxpayer documents — including checks — in an effort to dispose of caseload.<sup>3</sup> Although the General Accounting Office (GAO, now the Government Accountability Office) verified specific losses and confirmed IRS remedial steps, no subsequent IRS history set forth lessons learned from this episode.<sup>4</sup> While officials may have been understandably apprehensive about casting personal blame, the lesson of history rather would be to identify positive and negative precedents for the future.

More recently, the IRS piloted a pre-certification program that required Earned Income Tax Credit (EITC) claimants either to verify their eligibility for the credit before the IRS accepted their claims, or to attach documentation of eligibility to their tax returns. Ultimately, the IRS decided not to pursue pre-certification because the results of the pilot indicated that the program decreased participation in the EITC while increasing cost and burden on taxpayers.<sup>5</sup> While this conclusion may be found in various reports, no IRS historical analysis puts together the pieces, which include resistance and even litigation by residents and officials of Hartford, Connecticut, where the pilot took place.<sup>6</sup> In its perennial efforts to improve

<sup>1</sup> W. Elliot Brownlee, *Federal Taxation in America: A Short History*, 2nd ed. (Cambridge Univ. Press, 2004) 125 n. 20.

<sup>2</sup> Statement of Shelley Davis, former IRS Historian, *Practices & Procs. of the IRS*, Hearings Before the Comm. on Finance, U.S. Sen., S. Hrg. 105-190, 105th Cong. 1st Sess. (Sept. 23-25, 1997) 35.

<sup>3</sup> See GAO, *Information on IRS Service Centers in Austin, Texas and Fresno, California*, GGD-85-89 (Sept. 30, 1986); GAO, *Information on IRS Philadelphia Service Center*, GD-86-25FS (Nov. 1985).

<sup>4</sup> See Shelley L. Davis, *Unbridled Power: Inside the Secret Culture of the IRS* (NY: HarperCollins, 1997).

<sup>5</sup> See National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, at 75, 84 (Research Study: *Running Social Programs Through the Tax System*); IRS, *Earned Income Tax Credit (EITC) Initiatives, Addendum to the Report on Qualifying Child Residency, Certification, Filing Status, and Automated Underreporter Tests: Implementation of Alternative Approaches to Improving the Administration of EITC* (2008); IRS, *Earned Income Tax Credit Initiative: Final Report to Congress* (Oct. 2005).

<sup>6</sup> See Stephen D. Holt, *Keeping it in Context: Earned Income Tax Credit Compliance and Treatment of the Working Poor*, 6 Conn. Public Interest L.J. 183 (2007).

EITC compliance, the IRS may be prone to repeat attempts that could be revealed by a complete history.

### RECOMMENDATION

Create a permanent position within the IRS for a historian with expertise in federal taxation as well as archival methods. Mandate that the IRS historian record history objectively, accurately, and without deletion. To ensure historical expertise regardless of contemporary IRS policies, align the appointment with the Archivist of the United States rather than the Commissioner of Internal Revenue.

### PRESENT LAW

Generally, federal laws require retention of and access to IRS and other government records, but no law requires IRS publication of history. Under the Federal Records Act, the IRS, as a government agency, shall preserve records containing adequate and proper documentation of its organization, functions, policies, decisions, procedures, and essential transactions.<sup>7</sup> While determining what constitutes “adequate and proper documentation” could be the province of a professional historian’s judgment, the IRS delegates responsibility for compliance with record retention and related laws to a Records and Information Management program within its Real Estate and Facilities Management function.<sup>8</sup> Additionally, a Servicewide Policy, Directives, and Electronic Research (SPDER) function within the IRS Research, Analysis and Statistics division maintains an Organizational History Library documenting organizational realignments and changes in functional responsibilities of the agency.<sup>9</sup>

“In our democracy, the Freedom of Information Act (FOIA), which encourages accountability through transparency, is the most prominent expression of a profound national commitment to ensuring an open Government.”<sup>10</sup> Generally, access to federal records is governed by FOIA,<sup>11</sup> which in the IRS is administered by a Disclosure Office within the Small Business/Self-Employed division. FOIA excepts from disclosure any information protected by statute, the most notable of which in this case is Internal Revenue Code (IRC) § 6103, which generally requires that returns and return information be kept confidential.<sup>12</sup>

<sup>7</sup> 44 U.S.C. § 3101.

<sup>8</sup> See Internal Revenue Manual (IRM) 1.15.1 (Dec. 19, 2008).

<sup>9</sup> IRM 1.11.1, Exhibit 1.11.1-2 (Sept. 4, 2009), authored by SPDER, contains a description of the IRS Historical Research Library. A more specific intranet page for IRS employee access relates to Organizational History. <http://oldirm.web.irs.gov/search/orghist.asp> (last visited Oct. 17, 2011).

<sup>10</sup> Memorandum of January 21, 2009 - Transparency & Open Gov’t, 74 Fed. Reg. 4,683 (Jan. 26, 2009).

<sup>11</sup> See 5 U.S.C. § 552.

<sup>12</sup> See 5 U.S.C. § 552(b)(3).

## REASONS FOR CHANGE

Preeminent scholars have observed that while “decision-makers always draw on past experience, whether conscious of doing so or not,” the “uses now made of history can be more reflective and systematic, hence more helpful.”<sup>13</sup> Federal use of history has a venerable lineage. For example, President Franklin D. Roosevelt ordered federal agencies to record objectively the history of their activities in order to assess policy and departmental effectiveness.<sup>14</sup> During and after World War II, General Dwight D. Eisenhower supported the history programs of the armed services, employing many academically trained historians and publishing notable volumes.<sup>15</sup>

In any case, thoughtful study of history can help accomplish a mission because understanding agency origins and development aids in comprehending the present situation and illuminates possible future directions.<sup>16</sup> As exemplified above, knowledge of history can prevent the IRS from repeating past efforts that proved fruitless. History may offer the best diagnosis of breakdown in a system so complex that no single cause is to blame.<sup>17</sup>

## EXPLANATION OF RECOMMENDATION

At least 29 federal agencies, including all branches of the military and encompassing 11 Cabinet departments, employ historians.<sup>18</sup> These professionals may play roles in presenting history to the public, as in museums (Smithsonian), libraries (Library of Congress), and monuments (National Park Service). Other historians may play programmatic roles, such as uncovering evidence of war crimes or environmental damage for prosecutorial or defense offices in the Department of Justice.<sup>19</sup> Finally, some offices may conduct institutional history, in the mode of subdisciplines recognized as military or diplomatic history.

Some historians are authorized by statute, operating by law where history may be inherently controversial within the government. In particular, the custodian of federal diplomatic history is the Historian of the Department of State, who is mandated to publish “a thorough, accurate, and reliable documentary record of major United States foreign policy

<sup>13</sup> Richard E. Neustadt & Ernest R. May, *Thinking in Time: The Uses of History for Decision-Makers* (NY: Free Press, 1986) xiii, 2.

<sup>14</sup> Exec. Ord. cited by Roger D. Launius, *NASA History and the Challenge of Keeping the Contemporary Past*, 21 *Public Historian* 63 (1999).

<sup>15</sup> 21 *Public Historian* at 65.

<sup>16</sup> *Id.*

<sup>17</sup> See Chas. Perrow, *The Meltdown Was Not an Accident*, *Markets on Trial: The Economic Sociology of the U.S. Financial Crisis*, ed. Michael Lounsbury & Paul M. Hirsch, 30 *Res. in the Sociol. of Org'ns* 309 (2010); Chas. Perrow, *Normal Accidents: Living With High Risk Technologies* rev. ed. (Princeton Univ. Press, 1999); National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, *infra* (Research Study: *From Tax Collector to Fiscal Automaton: Demographic History of Federal Income Tax Administration, 1913-2011*).

<sup>18</sup> See Dir. of Fed. Hist. Ofcs. at <http://shfg.org/shfg/publications/directory-of-history-offices/> (last visited Aug. 23, 2011).

<sup>19</sup> See Eli M. Rosenbaum, *An Introduction to the Work of the Office of Special Investigations*, 54 *U.S. Attys' Bull.* 1, 4 (2006) (“A unique aspect of OSI’s operating methodology is its use of staff historians to conduct the bulk of the investigative work.”); Andrew Sorokowski, *Forensic History in Superfund Counterclaims: The CERCLA Counterclaim at the Juncture of History and Environmental Law*, 22 *Federalist: Newsltr. of Soc’y for Hist. in Fed. Gov’t* (Summer 2009) 5.

decisions and significant United States diplomatic activity.”<sup>20</sup> Moreover, this publication shall be guided by the principles of historical objectivity and accuracy. Records

shall not be altered and deletions shall not be made without indicating in the published text that a deletion has been made. The published record shall omit no facts that were of major importance in reaching a decision, and nothing shall be omitted for the purpose of concealing a defect of policy.<sup>21</sup>

Other historians recognized by statute include the Archivist who heads the National Archives and Records Administration,<sup>22</sup> and the Historians of the Senate and House of Representatives.<sup>23</sup> Statutory authorization may protect historians from dismissal when objectivity entails embarrassing facts.

History may be either promotional or critical. Popularizing the history of IRS accomplishments can be a productive aspect of civic education. On the other hand, constructive criticism in areas where the IRS can improve also may enhance tax administration in the long run even if it causes discomfort to contemporary officials. While professionals have observed that government “agencies, sometimes consciously, sometimes unknowingly, occasionally pressure history offices to use history selectively to further agency programs,” as an ethical matter, “Historians are dedicated to the truth and to full disclosure.”<sup>24</sup>

Consequently, legislation creating a position for an IRS historian should mandate objectivity as does the statute for the State Department Historian quoted above. Likewise, professional objectivity should be ensured by making the IRS historian the appointee of a subject-matter expert outside the agency. In the case of the National Taxpayer Advocate, an IRS official with access to return information under IRC § 6103, the law ensures independence by making her an appointee of the Secretary of the Treasury rather than the Commissioner of Internal Revenue.<sup>25</sup> In addition, the National Taxpayer Advocate’s mandated reports to Congress are not subject to review by the Commissioner, Secretary of the Treasury, the Oversight Board, any other officer or employee of the Department of the Treasury, or the Office of Management and Budget.<sup>26</sup>

By the same token, the IRS historian should be selected (and subject to removal) by the Secretary of the Treasury in consultation with the Archivist of the United States, the keeper of federal history, rather than the Commissioner. Day-to-day, the IRS historian nevertheless would report directly to the Commissioner, and the proposal would confirm that the his-

<sup>20</sup> 22 U.S.C. § 4351(a).

<sup>21</sup> 22 U.S.C. § 4351(b).

<sup>22</sup> See 44 U.S.C. § 2102.

<sup>23</sup> See 44 U.S.C. § 2702 added by Pub. L. No. 101-509 (1990).

<sup>24</sup> Martin Reuss, *Government and Professional Ethics: The Case of Federal Historians*, 21 *Public Historian* 135, 136 & 140 (1999).

<sup>25</sup> See IRC § 7803(c)(1)(B)(ii).

<sup>26</sup> See IRC § 7803(c)(2)(B)(iii).

torian would have access to return information as a Treasury employee. Like the National Taxpayer Advocate, whose appointment is in the control of an official outside the IRS, the historian would be subject to ultimate sanction only by the Secretary of the Treasury in consultation with the Archivist, who in turn could be the professional arbiter of objectivity in the IRS historian's reports. This protocol would relieve the Commissioner, Secretary, and President, who may have competing policy interests, from reviewing the reports before publication. This arrangement would empower the IRS historian to speak the sometimes inconvenient truth that can improve tax administration.