

NATIONAL TAXPAYER ADVOCATE

ANNUAL REPORT TO CONGRESS

Executive Summary:

Preface and
Highlights

2014



This report is dedicated

to

The Honorable Dave Camp,

Upon his retirement from Congress,

In recognition of

And appreciation for

His tireless work

To advance the cause

of

Comprehensive tax reform.



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PREFACE: Introductory Remarks by the National Taxpayer Advocate

HONORABLE MEMBERS OF CONGRESS:

I respectfully submit for your consideration the National Taxpayer Advocate's 2014 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems.

In this year's report, I attempt to make the case for four major points:

- First, the budget environment of the last five years has brought about a devastating erosion of taxpayer service, harming taxpayers individually and collectively;
- Second, the lack of effective administrative and congressional oversight, in conjunction with the failure to pass Taxpayer Rights legislation, has eroded taxpayer protections enacted 16 or more years ago;
- Third, the combined effect of these trends is reshaping U.S. tax administration in ways that are not positive for future tax compliance or for public trust in the fairness of the tax system; and
- Fourth, this downward slide can be addressed if Congress makes an investment in the IRS and holds it accountable for how it applies that investment.

Moreover, I believe we need fundamental tax reform, sooner rather than later, so the entire system does not implode.¹ Although this year's report does not focus on tax reform, I have recommended tax reform in my reports and congressional testimony for many years.²

The devastating erosion of taxpayer service harms taxpayers individually and collectively.

As the nation's advocate for taxpayers, I feel compelled to speak up about the degradation of service provided by the IRS in all aspects of its work, primarily in its pre-filing and filing activities but also in its

1 For a discussion of the role the IRS could play in addressing the complexity of the tax code, see Most Serious Problems: *COMPLEXITY: The IRS Does Not Report on Tax Complexity as Required by Law; and COMPLEXITY: The IRS Has No Process to Ensure Front-Line Technical Experts Discuss Legislation with the Tax Writing Committees, as Requested by Congress, infra.*

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

enforcement activities. We outline this sad state of affairs in the first five Most Serious Problems discussed herein, which cover in detail the crisis in taxpayer service and its effects on taxpayers of all ilk.³

As we note in Most Serious Problem #1, *TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*, the IRS's inflation-adjusted budget has declined by about 17 percent between Fiscal Years (FYs) 2010 and 2015. Yet during this period, the number of taxpayers (individual and business) has increased significantly, along with the scope and complexity of the tax system and the duties assigned to the IRS. The sheer size of the IRS's annual workload can be demonstrated by just a few statistics for FY 2014:

- Nearly 160 million individual and business returns filed;⁴
- More than 100 million phone calls received;⁵
- Nearly 10 million pieces of correspondence received about taxpayer account issues;⁶ and
- More than 5 million taxpayer visits to IRS walk-in sites.⁷

Similarly, the decay in taxpayer service can also be summed up by a few FY 2014 statistics:

- 35.6 percent of phone calls went unanswered by customer service representatives;
- 50 percent of pieces of correspondence were not handled timely;
- Virtually zero tax returns were prepared by IRS walk-in sites;
- Only about 6 percent of the outreach and education budget of the Wage and Investment Division, which is responsible for helping approximately 126 million individuals understand and comply with their tax obligations, is devoted to activities that involve face-to-face contact with taxpayers. Thus, localized outreach and education have nearly disappeared.
- In 13 states, no outreach and education employees were focused on the 65 million small business and self-employed taxpayers served by the Small Business/Self-Employed Division.⁸

When the IRS does not answer the calls its taxpayers are making to it, and when it does not timely read and respond to the letters its taxpayers are sending it, the tax system goes into a downward spiral. Taxpayers do not get answers to their questions, so they must either pay for advice they would otherwise obtain for free, or they proceed without any advice at all, leading to future compliance problems (and

3 The first five most serious problems are: *TAXPAYER SERVICE: Taxpayer Service Has Reached Unacceptably Low Levels and Is Getting Worse, Creating Compliance Barriers and Significant Inconvenience for Millions of Taxpayers*; *TAXPAYER SERVICE: Due to the Delayed Completion of the Service Priorities Initiative, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions*; *IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*; *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*; and *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design Grant Structure Is Not Adequately Based on Specific Needs of Served Taxpayer Populations*.

4 IRS Publication 6292, *Fiscal Year Return Projections for the United States 2014-2021*, at 4 (Fall 2014).

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

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

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

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

more burden for the taxpayer and more work for the IRS). Taxpayers are unable to provide the IRS with information that would resolve a problem with a return or an audit issue. And taxpayers are unable to talk with an IRS employee about how they can pay their past tax debts using collection alternatives available under the tax laws.

Most people understand that the Taxpayer Services budget category includes the IRS phone system and the correspondence system. But few people understand that what is covered by IRS phone and paper activity touches just about every taxpayer in some aspect of his, her, or its interaction with the tax system. To wit:

- Taxpayer Services annually involves the acceptance and processing of all returns for individuals, businesses (including payroll tax), and information reporting (including W-2s, 1099s, and new forms required under the Affordable Care Act).
- Taxpayer Services includes issuing refunds, depositing tax payments and other remittances, resolving errors or issues identified in the processing of returns, including refund fraud and identity theft, and processing amended returns.
- Taxpayer Services includes handling taxpayer calls and processing taxpayer responses to IRS notices about math error adjustments, penalty abatements, automated substitutes for returns, and automated underreporter adjustments, as well as statutory notices of deficiency.
- Taxpayer Services includes answering phone calls from taxpayers requesting installment agreements and other payment arrangements, including those seeking currently not collectible (CNC) status because of economic hardship.

For every phone call or piece of correspondence that goes unanswered, there is a great likelihood problems will arise that will require more IRS resources and impose more burden on taxpayers to later resolve. The correspondence inventory backlogs will spill over into the next filing season, further reducing the IRS's ability to deliver a satisfactory filing season in years to come.

For FY 2015, the IRS originally projected it would achieve a 54 percent level of service (LOS) on the phones, meaning that almost half of the taxpayers wanting to speak with a live assistor would not get through.⁹ It also projected that about half its correspondence would be over-aged (meaning that, on average, about half of the correspondence would not be processed within 45 days of receipt). However, with the receipt of the final FY 2015 appropriation, the state of affairs for taxpayers is much worse.

Specifically, the IRS projects that, depending on when the IRS releases its seasonal workers, the level of service on the phones could be as low as 43 percent (on average, which means that on any given day the LOS could be truly abysmal) and it may be unable to handle up to 1.9 million fewer pieces of correspondence as compared with FY 2014.¹⁰ Thus, potentially millions of taxpayers will not be able to reach the IRS when they need to, and their written communications will go unanswered or unaddressed. Taxpayers will not get their math error notices corrected or penalties abated, leading to incorrect assessments and expensive downstream dispute resolution activities, including audit reconsideration, appeals, and litigation. Taxpayers will be unable to talk with IRS employees about making payment arrangements, resulting in automated and unnecessary liens and levies and leading to expensive downstream activities like levy releases and lien releases and withdrawals. For every phone call or piece of correspondence that goes unanswered, there

⁹ Wage & Investment Business Performance Review Fourth Quarter (Nov. 6.), 2014) at 4.

¹⁰ IRS Senior Executive Team discussion (Dec. 23, 2014) (information on file with the National Taxpayer Advocate).

is a great likelihood problems will arise that will require more IRS resources and impose more burden on taxpayers to later resolve. The correspondence inventory backlogs will spill over into the next filing season, further reducing the IRS's ability to deliver a satisfactory filing season in years to come.

Why would anyone want to go this route? The answer, I think, is that no one really wants to go this way, but everyone is in collective denial about what inadequate funding for the IRS means to taxpayers.

This denial must stop. We have to face up to the fact that we have an incredibly complex tax system that, by virtue of its complexity, creates burden, confusion, and unfairness. It is a challenge for any tax agency to properly administer a system such as the one we have. But it is *impossible* for an underfunded tax agency to do so. The victims of this underfunding are not the IRS and its employees—the victims are U.S. taxpayers.

Congress must act to ensure existing taxpayer rights protections are properly implemented and new protections are put in place.

On June 10, 2014, the IRS formally adopted the Taxpayer Bill of Rights (TBOR) that I have long recommended and advocated for.¹¹ I have followed the TBOR as the North Star for this Report. In the Report's major sections—the Most Serious Problems Encountered by Taxpayers, Legislative Recommendations, and Most Litigated Issues—in almost every case, we have linked each of the issues discussed to one or more of the foundational rights taxpayers have under our TBOR. We do so in order to demonstrate that the TBOR can and should guide our every action in tax administration.

Between 1988 and 1998, Congress passed three landmark pieces of legislation establishing taxpayer rights protections and providing remedies for violations of those protections.¹² As we identify in *each* of the 23 Most Serious Problems of taxpayers discussed in this report, these protections have not been implemented as envisioned. There are many reasons for the IRS's failure to adequately implement the provisions. In some cases, legal interpretation has diluted the original legislative goal.¹³ In other instances, the tax system itself has changed so much that provisions enacted nearly three decades ago no longer fit today's administrative processes.¹⁴ Sometimes, implementation has been delayed or cannot be achieved because of the design of the IRS's existing technology systems.¹⁵ In all instances, we make recommendations for how the IRS can improve its administration of these provisions so they provide substantive protection to U.S. taxpayers.

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

12 See Technical and Miscellaneous Revenue Act, Pub. L. No. 100-647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the "Omnibus Taxpayer Bill of Rights," also known as TBOR 1); Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act, Pub. L. No. 105-206, 112 Stat. 685 (1998) (Title III is known as "Taxpayer Bill of Rights 3" or TBOR 3).

13 See, e.g., the following most serious problems discussed *infra*: *AUDIT NOTICES: The IRS's Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability*; *CORRESPONDENCE EXAMINATION: The IRS has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers*; *STATUTORY NOTICES OF DEFICIENCY: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notices*; and *MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98*.

14 See, e.g., Most Serious Problem: *ACCESS TO THE IRS: Taxpayers are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues*, *infra*.

15 See, e.g., Most Serious Problem: *VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services*, *infra*.

The erosion of taxpayer trust is an even more serious matter than the erosion of taxpayer service, because with the provision of adequate funding, declines in taxpayer service can be reversed. Not so with declines in trust—once lost, trust takes a very long time to be regained. For a taxpayer whose trust has been shaken, each IRS failure to meet basic expectations (e.g., answer the phone ...) confirms the belief that the IRS is not to be trusted.

But the work toward creating a vital system of taxpayer rights with enforceable remedies for violations of those rights is not yet done. Over the last year, my office has identified areas where taxpayer rights protections are weak or nonexistent under current law, and other areas where the IRS has resisted Congress's direction in past legislation.

Thus, my number one Legislative Recommendation is that Congress enact landmark taxpayer rights legislation this year, which would include codification of the Taxpayer Bill of Rights and adoption of the taxpayer rights legislative recommendations my office and others have made since 1998. For everyone's convenience, we summarize those legislative proposals, aligned with the rights they protect.¹⁶

Passage of a taxpayer rights bill will accomplish several things that are desperately needed in today's environment. First, it will create a vehicle for a meaningful discussion about taxpayer rights, the role they play in promoting voluntary compliance, and what mechanisms exist to instill the protection of taxpayer rights into every nook and cranny of tax administration. Second, by codification of the TBOR and enforceable remedies for violations of rights enunciated in the TBOR, the United States will become the model for the world in the protection of taxpayer rights. Third, and most importantly, this combination of rights and remedies will begin to restore the U.S. taxpayers' trust in the tax system.

The emerging shape of U.S. tax administration is not encouraging for future tax compliance or taxpayers' trust in the fairness of tax administration.

For the last five years or so, the Office of the Taxpayer Advocate has undertaken some of the most important studies conducted to date about the factors influencing taxpayers' compliance behavior.¹⁷ In a study of sole proprietors, who IRS research data show are responsible for the largest portion of the tax gap, we found that trust in the government, in the IRS, and in the fairness of the tax system is the greatest corollary to tax compliance behavior. Specifically, the factors that appear to have the greatest influence on whether a taxpayer is compliant or noncompliant are the norms of the taxpayer's community and the provision of taxpayer service.

As noted above, the IRS is not providing adequate taxpayer service these days. Per our studies, this does not bode well for the future compliance behavior of taxpayers. But the erosion of taxpayer trust is an even more serious matter than the erosion of taxpayer service, because with the provision of adequate funding, declines in taxpayer service can be reversed. Not so with declines in trust. Once lost, trust takes a very long time to be regained. For a taxpayer whose trust has been shaken, each IRS failure to meet basic expectations (e.g., answer the phone, listen carefully, consider the specific facts and circumstances, provide alternatives, take the extra step to help) confirms the belief that the IRS is not to be trusted.

¹⁶ See Legislative Recommendation: *TAXPAYER RIGHTS: Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections*, *infra*.

¹⁷ See National Taxpayer Advocate 2013 Annual Report to Congress, vol. 2, 60-61 (*Small Business Compliance: Further Analysis of Influential Factors*); National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2, 1-70 (*Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*). See also National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 138-50 (Marjorie E. Kornhauser, *Normative and Cognitive Aspects of Tax Compliance: Literature Review and Recommendations for the IRS Regarding Individual Taxpayers*).

The IRS will never be a beloved federal agency, because it is the face of the government's power to tax and collect. But it should be a *respected* agency. When there are accusations of bias or heavy-handed actions by the tax agency, these reinforce the already deep concerns the U.S. taxpayer bears toward taxes, such concerns going back to the nation's founding. But casting the entire agency and all its employees as an out-of-control agency in response to the actions of a few, no matter how deplorable those actions may be, is harmful to taxpayers and to tax compliance.¹⁸ We need to recognize that the IRS and its employees play a vital role in the economic welfare of this country. And we need to find a way to support the agency even as we hold it accountable for what is often a thankless task.

The IRS will never be a beloved federal agency, because it is the face of the government's power to tax and collect. But it should be a *respected* government agency.... We need to recognize that the IRS and its employees play a vital role in the economic welfare of this country. And we need to find a way to support the agency even as we hold it accountable for what is often a thankless task.

Congress must simultaneously make an investment in the IRS and hold it accountable for how it applies that investment.

I have spent my entire professional life protecting the rights of taxpayers, individually and collectively, and advocating for systemic changes in the tax system. I firmly believe that the best way to improve the IRS is to have active, consistent oversight of and support for the agency by both the Administration and Congress.

On the Administration's part, this means (1) proposing budgets that recognize and fund the important role taxpayer service plays in promoting voluntary compliance; (2) establishing administrative remedies to protect taxpayer rights; (3) establishing performance measures that promote taxpayer rights; and (4) holding IRS officials accountable for violations of taxpayer rights. In order to measure the IRS's performance in fulfilling the promise of the Taxpayer Bill of Rights, we present, as an appendix to this Preface, an assessment of taxpayer rights performance measures that lists specific data under each of the ten rights. In future reports, we will develop this assessment and fill in any data gaps.

As discussed earlier, Congress can both support the IRS and hold it accountable by funding the IRS adequately to conduct the task of administering the complex system Congress has enacted. It can, and should, enact taxpayer rights legislation, including TBOR codification. But on an ongoing basis, Congress should exercise its oversight authority by holding regular hearings on IRS activity—not just on the issue *du jour* but on all the routine work the IRS does. Focusing on current tax administration challenges, these hearings could address the following questions:

- With respect to taxpayer service, what data did the IRS rely on to decide to limit the scope of tax-law questions on the phones or in person, or eliminate tax return preparation in the Taxpayer Assistance Centers?¹⁹

18 In this Report, I make substantive legislative proposals to address one source of taxpayers' distrust of the IRS, e.g., its handling of political campaign activities by IRC § 501(c)(4) social welfare organizations. See Legislative Recommendation: *Section 501(c)(4) Political Campaign Activity: Enact an Optional "Safe Harbor" Election That Would Allow IRC § 501(c)(4) Organizations to Ensure They Do Not Engage in Excessive Political Campaign Activity*, and Legislative Recommendation: *EO Judicial and Administrative Review: Allow IRC § 501(c)(4), (c)(5), or (c)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status*, *infra*.

19 See Most Serious Problem: *TAXPAYER SERVICE: Due to the Delayed Completion of the Service Priorities Initiative, the IRS Currently Lacks a Clear Rationale for Taxpayer Service Budgetary Allocation Decisions*, *infra*.

- Is the IRS effectively utilizing its existing resources to collect past-due tax liabilities, or does it, as I believe, need to completely revise its approach to collection?²⁰
- Does the IRS's approach to penalty administration promote voluntary compliance, or is it confirming taxpayers' belief that the system is stacked against them and thus increasing noncompliant behavior?²¹
- Do IRS employees have the appropriate education and skills to deal with such diverse populations as those subject to the offshore account reporting regimes and those eligible for the Earned Income Tax Credit (EITC)?²²
- Is the future vision of the IRS going to leave low income taxpayers—who constitute over 40 percent of the U.S. population—behind, as the IRS moves away from person-to-person communication and toward online information?²³
- What is the impact on taxpayer attitudes and voluntary compliance if the only time a taxpayer has direct contact with an IRS employee is when that employee is taking an enforcement action (*i.e.*, conducting an audit or imposing a penalty, lien, or levy)?²⁴

These are profound issues for the future of our tax system, which annually touches more people in the U.S. than any other federal government agency. Bipartisan, dispassionate congressional hearings on these issues, with testimony not just from IRS personnel, GAO, and TIGTA, but also from academics and other experts, tax professional groups, and low income taxpayer clinics, would help create a framework for what the IRS needs and how it should operate in order to gain the trust of U.S. taxpayers in the twenty-first century. Along the way, taxpayers can begin to be educated about the daily work of the IRS and the reasons for its actions.

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- 20 See Most Serious Problem: *OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure*, *infra*, and Most Serious Problem: *COLLECTION DUE PROCESS: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections*, *infra*.
- 21 See Most Serious Problem: *PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote Voluntary Compliance, as Recommended by Congress and Others*, *infra*; Most Serious Problem: *OFFSHORE VOLUNTARY DISCLOSURE (OVD): The OVD Programs Initially Undermined the Law and Still Violate Taxpayer Rights*, *infra*; *FOREIGN ACCOUNT REPORTING: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure*, *infra*; and Legislative Recommendation: *ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit "Reasonable Cause" Relief*, *infra*.
- 22 See Most Serious Problem: *Workload Selection: The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy*, *infra*.
- 23 See U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement, *Age and Sex of All People, Family Members and Unrelated Individuals Iterated by Income-to-Poverty Ratio and Race, Below 250% of Poverty*, (2013 and 2007 poverty data, available at <http://www.census.gov/hhes/www/poverty/data/incpovhlth/2013/index.html>). From tax year 2013 returns and based on the HHS 2013 poverty levels, the percent of taxpayers at or below 250 percent of poverty level is about 45 percent. Individual Returns Transaction File on IRS Compliance Data Warehouse. IRC § 7526 adopts 250 percent of federal poverty guidelines published by the Department of Health and Human Services as the general income eligibility level for Low Income Taxpayer Clinic assistance. Other IRS programs, including waivers of user fees for Offers in Compromise and exclusion from the Federal Payment Levy Program, adopt this definition. See Most Serious Problem: *VITA/TCE FUNDING: Volunteer Tax Assistance Programs Are Too Restrictive and the Design of the Grant Structure is Not Adequately Based on Specific Needs of Served Taxpayer Populations*, *infra*; Legislative Recommendation: *RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery*, *infra*; and Volume Two Research Study: *Low Income Taxpayer Clinic Program: A Look at Those Eligible to Seek Help from the Clinics*, *infra*.
- 24 See Most Serious Problem: *IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance*, *infra*; Most Serious Problem: *APPEALS: The IRS Lacks a Permanent Appeals Presence in 12 States and Puerto Rico, Thereby Making It Difficult for Some Taxpayers to Obtain Timely and Equitable Face-to-Face Hearings with an Appeals Officer or Settlement Officer in Each State*, *infra*; and Volume 2 Research Study: *Estimating the Impact of Audits on the Subsequent Reporting Compliance of Small Business Taxpayers: Preliminary Results*, *infra*.

Finally, Congress must do its part to ensure that taxpayers have the *right to a fair and just tax system* by enacting fundamental tax reform—a reform that brings sanity and clarity for all taxpayers. That would be good for our country, for our taxpayers, and for the IRS.

The increasing workload the IRS faces, the erosion of public trust occasioned by the IRS's highly publicized use of terms like “tea party” in screening organizations applying for tax-exempt status and related management issues, and the sharp reduction in funding have created a “perfect storm” of trouble for effective tax administration. Taxpayers who need help are not getting it, and tax compliance is likely to suffer over the longer term if these problems are not quickly and decisively addressed.

Now more than ever, Congressional involvement is needed to repair the damage and place tax administration on a better path forward. In the short term, I urge Congress to take the following steps:

- Enact a true Taxpayer Bill of Rights along the lines I describe in this report in order to protect taxpayers and help restore their trust in the fairness of the system;
- Conduct meaningful oversight hearings into the nuts and bolts of tax administration that haven't captured public attention in the same way as certain other issues but shape the experiences of millions of taxpayers in critical ways every day; and
- Along with proper oversight, provide the IRS with the additional funding it needs to answer taxpayer phone calls and otherwise do its job well.

Over the long term, I urge Congress to enact comprehensive tax reform, with simplification as a key goal.

I look forward to working with Congress on these important issues in the coming year, and I remain hopeful that we can provide U.S. taxpayers with the quality tax system they both need and deserve.

Respectfully submitted,



Nina E. Olson
National Taxpayer Advocate
31 December 2014

TAXPAYER RIGHTS ASSESSMENT: IRS Performance Measures and Data Relating to Taxpayer Rights

In the 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a “report card” of measures that would “...provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance.”²⁵

On June 10, 2014, the IRS adopted a Taxpayer Bill of Rights (TBOR), a list of ten rights that the National Taxpayer Advocate recommended to help taxpayers and IRS employees alike gain a better understanding of the dozens of discrete taxpayer rights spread throughout the multi-million word Internal Revenue Code.²⁶ While this was a significant achievement for increasing taxpayers’ awareness of their rights, and an important first step in integrating taxpayer rights into all aspects of tax administration, more can be done. The *Taxpayer Rights Assessment* contains selected performance measures and data organized by the ten taxpayer rights and is another important step toward integrating taxpayer rights into tax administration.

This *Taxpayer Rights Assessment* is a work in progress. The following measures provide insights into IRS performance; but they are by no means comprehensive. In some instances, data is not readily available. In other instances, we may not yet have sufficient measures in place to evaluate adherence to specific taxpayer rights. And, despite what the numbers may show, we must pay particular attention to the needs of taxpayers who lack access to quality service even if overall performance metrics are improving. This *Taxpayer Rights Assessment* will grow and evolve over time as data becomes available and new concerns emerge.

- 1. THE RIGHT TO BE INFORMED** – Taxpayers have the right to know what they need to do to comply with the tax laws. They are entitled to clear explanations of the laws and IRS procedures in all tax forms, instructions, publications, notices, and correspondence. They have the right to be informed of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.

Measure/Indicator	FY 2014
Individual Correspondence Volume (adjustments) ^a	5,700,132
Average Days in Inventory ^b	57.6 days
Inventory Overage ^c	63.6%
Business Correspondence Volume (adjustments) ^d	3,471,571
Average Days in Inventory ^e	39 days
Inventory Overage ^f	17.5%
Total Correspondence (all types)	TBD
Quality of IRS Forms & Publications	TBD
IRS.gov Web Page Ease of Use	TBD
IRS Outreach	TBD

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

b IRS, Joint Operations Center, Weekly Enterprise Adjustments Inventory Report, FY 2014, week ending Sept. 27, 2014.

c *Id.*

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

e IRS, Joint Operations Center, Weekly Enterprise Adjustments Inventory Report, FY 2014, week ending Sept. 27, 2014.

f *Id.*

25 See National Taxpayer Advocate 2013 Annual Report to Congress, Preface, xvii-xviii (*Taxpayer Service Is Not an Isolated Function but Must Be Incorporated throughout All IRS Activities, Including Enforcement*).

26 IRS Press Release IR-2014-72, June 10, 2014 (*IRS Adopts “Taxpayer Bill of Rights;” 10 Provisions to be highlighted on IRS.gov, in Publication 1*).

2. THE RIGHT TO QUALITY SERVICE – Taxpayers have the right to receive prompt, courteous, and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easily understandable communications from the IRS, and to speak to a supervisor about inadequate service.

Measure/Indicator	FY 2014
Number of Returns Filed (projected, all types) ^a	243,077,800
Total Individual Income Tax Returns ^b	147,812,000
E-file Receipts (Received by 11/21/14) ^c	125,821,000
E-file: Tax Professional ^d	62%
E-file: Self Prepared ^e	38%
Returns Prepared by:	
VITA/TCE/AARP ^f	3,322,582
Free File Consortium ^g	2,406,465
Fillable Forms ^h	478,501
IRS Taxpayer Assistance Centers (TACs) ⁱ	376
Number of Taxpayer Assistance (“Walk-In”) Centers ^j	382
Number of TAC Contacts ^k	5,477,279
Total Calls to IRS (Enterprise) ^l	100,667,411
Number of Attempted Calls to IRS Accounts Management (AM – formerly Customer Service) Lines ^m	86,171,857
Toll Free: Percentage of calls answered ⁿ (LOS)	64.4%
Toll Free: Average Speed of Answer ^o	19.6 minutes
NTA Toll Free: Percentage of calls answered (LOS)	68.9%
NTA Toll Free: Average Speed of Answer ^p	7.0 minutes
Practitioner Priority: Percentage of calls answered (LOS)	70.4%
Practitioner Priority: Average Speed of Answer ^q	27.4 minutes
Tax Exempt/Government Entities Percentage of calls answered ^r (LOS)	67.6%
Tax Exempt/Government Entities: Average Speed of Answer ^s	18.7 minutes
Awareness of Service (or utilization)	TBD
IRS Issue Resolution – Percentage of taxpayers who had their issue resolved as a result of the service they received	TBD
Taxpayer Issue Resolution – Percentage of taxpayers who reported their issue was resolved after receiving service	TBD

a IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2014-2021*, at 4 (Fall 2014).

b *Id.*

c IRS, Filing Season Statistics, IRS Newsroom <http://www.irs.gov/uac/Newsroom/Nov-21-2014> (last viewed Nov. 26, 2014).

d *Id.*

e *Id.*

f *Id.* Free, in-person return preparation is offered to low income and older taxpayers by non-IRS organizations through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE), and AARP Tax-Aide programs.

g IRS Compliance Data Warehouse (CDW), Electronic Tax Administration Marketing Database (ETA MDB), frequency table.

h *Id.*

i IRS, E-File Reports, Field Assistance Report, Current Year Accepted, Jan – Sept. 30, 2014.

j Information received from Senior Advisor, Wage and Investment (Dec. 23, 2104). Three hundred eighty-nine Taxpayer Assistance Centers were open during the filing season, and 382 were open at the end of the fiscal year.

k Wage & Investment Division, Business Performance Review, 4th Quarter, FY2014. Dashboard, p.7.

l IRS, Joint Operations Center, Snapshot Reports: Enterprise Snapshot, week ending Sept. 30, 2014 (report generated Oct. 16, 2014).

m *Id.* Number of calls to Accounts Management (formerly Customer Services) - Sum of 30 lines (0217, 1040, 4933, 1954, 0115, 8374, 0922, 0582, 5227, 1778, 9887, 9982, 2942, 4184, 7388, 0452, 0352, 7451, 9946, 5215, 3536, 2050, 4017, 2060, 4778, 4259, 8482, 8775, 5500 and 4490). The IRS determines its level of service based on calls to Accounts Management, not total calls.

n *Id.* Calls answered include reaching live assistor or selecting options to hear automated information messages.

o *Id.*

p *Id.*

q *Id.*

r *Id.*

s *Id.*

3. THE RIGHT TO PAY NO MORE THAN THE CORRECT AMOUNT OF TAX – Taxpayers have the right to pay only the amount of tax legally due, including interest and penalties, and to have the IRS apply all tax payments properly.

Measure/Indicator	FY 2014
Toll-Free Tax Law Accuracy ^a	95.0%
Toll-Free Accounts Accuracy ^b	96.2%
Scope of Tax Law Questions Answered	TBD
Correspondence Examinations (Form 1040 Series)	
No change rate ^c	17.3%
Agreed rate ^d	17.2%
Non-response rate ^e	44.4%
Percentage of cases appealed	TBD
Field Examinations (Form 1040 Series)	
No change rate ^f	15.5%
Agreed rate ^g	46.6%
Non-response rate ^h	0.3%
Percentage of cases appealed	TBD
Office Examinations (Form 1040 Series)	
No change rate ⁱ	13.7%
Agreed rate ^j	45.0%
Non-response rate ^k	19.0%
Percentage of cases appealed	TBD
Math Error Adjustments	TBD
Math Error Abatements	TBD
Number of Statutory Notices of Deficiency Issued	TBD
Number of Statutory Notices of Deficiency Appealed	TBD
Number of Collection Appeals Program Conferences	TBD
Number of Collection Appeals Program Conferences Reversing IRS position	TBD
Number of Collection Due Process Conferences	TBD
Number of Collection Due Process Conferences Reversing IRS position	TBD
Percentage of taxpayers subject to IRS burden (e.g., received a notice from math error, AUR, ASFR, audit, collection, or had a refund delayed) who were (or may have been) compliant (i.e., those whose math error, AUR, or ASFR resulted in no net increase in tax, those with delayed refunds that were ultimately paid, those who appeared to have delinquencies but where nothing was ultimately collected)	TBD

a IRS Wage & Investment Division, Business Performance Review, 4th Quarter, FY2014 (Nov. 6, 2014) at 4.

b *Id.*

c IRS, Audit Information Management System, Closed Case Database. Includes disposal codes 1 and 2.

d *Id.* Includes disposal codes 3, 4, and 9.

e *Id.* Includes disposal code 13 or disposal code 10 in combination with technique codes 6 or 7.

f *Id.* Includes disposal codes 1 and 2.

g *Id.* Includes disposal codes 3, 4, and 9.

h *Id.* Includes only disposal code 13.

i *Id.* Includes disposal codes 1 and 2.

j *Id.* Includes disposal codes 3, 4, and 9.

k *Id.* Includes disposal code 13 or disposal code 10 in combination with technique codes 6 or 7.

- 4. THE RIGHT TO CHALLENGE THE IRS'S POSITION AND BE HEARD** – Taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions or proposed actions, to expect that the IRS will consider their timely objections and documentation promptly and fairly, and to receive a response if the IRS does not agree with their position.

Measure/Indicator	FY 2014
Individual Correspondence Volume (adjustments) ^a	5,700,132
Average Days in Inventory ^b	57.6 days
Inventory Overage ^c	63.6%
Business Correspondence Volume ^d	3,471,571
Average Days in Inventory ^e	39 days
Inventory Overage ^f	17.5%
Percentage of Math Error Adjustments Abated	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD
Number of Collection Appeal Program Conferences Requested by Taxpayers ^g	TBD
Percentage of CAP Conferences that Reversed the IRS Position	TBD
Number of Collection Due Process Hearings Requested by Taxpayers ^h	TBD
Percentage of Collection Due Process Hearings that Reversed the IRS Position	TBD

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

b IRS, Weekly Enterprise Adjustments Inventory Report, FY 2014, week ending Sept. 27, 2014.

c *Id.*

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

e IRS, Weekly Enterprise Adjustments Inventory Report, FY 2014, week ending Sept. 27, 2014.

f *Id.*

g Taxpayers may request a Collection Appeals Process (CAP) review as the result of IRS actions such as filing a Notice of Federal Tax Lien, an IRS levy or seizure of property, and termination, rejection, or modification of an installment agreement. See, IRS Pub. 1660, *Collection Appeal Rights*.

h Taxpayers may request a Collection Due Process (CDP) review when the IRS plans to take actions such as filing a federal tax lien or levy. See, IRS Pub. 1660, *Collection Appeal Rights*.

- 5. THE RIGHT TO APPEAL AN IRS DECISION IN AN INDEPENDENT FORUM** – Taxpayers are entitled to a fair and impartial administrative appeal of most IRS decisions, including many penalties, and have the right to receive a written response regarding the Office of Appeals' decision. Taxpayers generally have the right to take their cases to court.

Measure/Indicator	FY 2014
Number of Cases Appealed ^a	113,608
Appeals Staffing (On-rolls) ^b	1,704
Number of States without an Appeals or Settlement Officer ^c	12
Customer Satisfaction of service in Appeals	TBD
Average Days in Appeals to Resolution	TBD
Percentage of cases appealed	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD

a IRS Appeals Business Performance Review, 4th Quarter FY2014 (Nov. 10, 2014), at 9.

b *Id.*

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

- 6. THE RIGHT TO FINALITY** – Taxpayers have the right to know the maximum amount of time they have to challenge the IRS's position as well as the maximum amount of time the IRS has to audit a particular tax year or collect a tax debt. Taxpayers have the right to know when the IRS has finished an audit.

Measure/Indicator	FY 2014
Average Days to Complete Correspondence Examination (non-EITC) ^a	225 days
Average Days to Complete Correspondence Examination (EITC) ^b	243 days
Average Days to Reach Determination on Applications for Exempt Status ^c	237 days
Average Days for Exempt Organization Function to Respond to Correspondence ^d	66 days
Percentage of calls/letters/issues resolve in a single 2-way communication (single call, single meeting, or single exchange of correspondence)	TBD

a IRS, Wage & Investment Division, Business Performance Review, 4th Quarter, FY2014 (Nov. 6, 2014), at 8.

b *Id.*

c *Id.* at 16.

d *Id.*

- 7. THE RIGHT TO PRIVACY** – The right to privacy goes to the right to be free from unreasonable searches and seizures and that IRS actions would be no more intrusive than necessary. Taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will comply with the law and be no more intrusive than necessary, and will respect all due process rights, including search and seizure protections and will provide, where applicable, a collection due process hearing.

Measure/Indicator	FY 2014
Number (or percentage) of Collection Due Process cases where IRS cited for Abuse of Discretion	TBD
Number of Offers in Compromise Submitted using 'Effective Tax Administration' as Basis ^a	1,468
Percentage of Offers in Compromise Accepted that used 'Effective Tax Administration' as Basis ^b	2.1%
Number of cases where taxpayer received repayment of attorney fees as result of final judgment.	TBD

a IRS response to TAS fact check (Nov. 26, 2014).

b *Id.*

- 8. THE RIGHT TO CONFIDENTIALITY** – Taxpayers have the right to expect that any information they provide to the IRS will not be disclosed unless authorized by the taxpayer or by law. Taxpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information.

Measure/Indicator	FY 2014
Number of Unauthorized Access of Taxpayer Account (UNAX) Violations	TBD
Percentage of UNAX Violations Determined to be Inadvertent	TBD
Percentage of UNAX Violations Determined that Resulted in Discipline or Removal	TBD

- 9. THE RIGHT TO RETAIN REPRESENTATION** – Taxpayers have the right to retain an authorized representative of their choice to represent them in their dealings with the IRS. Taxpayers have the right to seek assistance from a Low Income Taxpayer Clinic if they cannot afford representation.

Measure/Indicator	FY 2014
Average Days for IRS to Process Power of Attorney Requests (Form 2848) ^a	3 Days
Percentage of Power of Attorney Requests Overage (as of Sept. 30, 2014) ^b	0%
Number of Low Income Taxpayer Clinics Funded ^c	131
Funds Appropriated for Low Income Taxpayer Clinics ^d	\$10 million
Number of States and other jurisdictions with a Low Income Taxpayer Clinic ^e	48
Number of Low Income Taxpayer Clinic Volunteer Hours ^f	60,229

a IRS, Joint Operations Center, Customer Account Services, Accounts Management Paper Inventory Reports FY 2014.

b *Id.*

c IRS Pub. 5066, *Low Income Taxpayer Clinics Program Report* (Dec. 2014).

d Consolidated Appropriations Act, Pub. L. No. 113-76, enacted Jan. 17, 2014.

e Forty-seven states and the District of Columbia have at least one Low Income Taxpayer Clinic. IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Dec. 2014).

f IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Dec. 2014).

- 10. THE RIGHT TO A FAIR AND JUST TAX SYSTEM** – Taxpayers have the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. Taxpayers have the right to receive assistance from the Taxpayer Advocate Service if they are experiencing financial difficulty or if the IRS has not resolved their tax issues properly and timely through its normal channels.

Measure/Indicator	FY 2014
Offer in Compromise: Number of Offers Submitted ^a	67,935
Offer in Compromise: Percentage of Offers Accepted ^b	41.9%
Installment Agreements: Number of Individual & Business IAs ^c	3,011,636
Streamlined Installment Agreements (ACS): Number of Individual & Business IAs ^d	2,857,043
Installment Agreements (CFF): Number of Individual & Business IAs ^e	52,619
Streamlined Installment Agreements (CFF): Number of Individual & Business IAs ^f	10,680
Number of OICs Accepted per Revenue Officer ^g	6.7
Number of IAs Accepted per Revenue Officer ^h	13.1
Percentage of Cases in the Queue (Taxpayers) ⁱ	15.6%
Percentage of Cases in the Queue (Modules) ^j	25.0%
Percentage of TDAs reported Currently Not Collectible – Surveyed ^k	18.2%
Age of Delinquencies in the Queue ^l	4.4 years
Percentage of Modules in Queue from TY 2010 and Prior ^m	80.2%
Percentage of cases where the taxpayer is fully compliant upon closure	TBD
Percentage of cases where the taxpayer is fully compliant after five years	42% ⁿ

a Collection Activity Report 5000-108 FY 2014 (Sep. 29, 2014).

b *Id.*

c Collection Activity Report 5000-6 FY 2014 (Sep. 29, 2014).

d *Id.*

e *Id.*

f *Id.*

g Collection Activity Report 5000-6 FY 2014 (Sep. 29, 2014); see also IRS Human Resources Reporting Center – number of revenue officers in SB/SE as of the end of FY 2014 (pay period 19).

h *Id.*

i Collection Activity Report 5000-2 FY 2014 (Sep. 29, 2014).

j Collection Activity Report 5000-6 FY 2014 (Sep. 29, 2014).

k Collection Activity Report 5000-2 FY 2014 (Sep. 29, 2014).

l Individual Master File Accounts Receivable Dollar Inventory as of the end of FY 2014 (cycle 201438).

m Collection Activity Report 5000-2 FY 2014 (Sep. 29, 2014).

n Calculation by TAS Research. Percentage of taxpayers with TDAs in 2009 who have no new delinquencies (TDAs or TDIs) five years later. IRS, Individual Master File.

THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2013, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 23 such problems.

THE RIGHT TO QUALITY SERVICE

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

Problem

The most serious problem facing U.S. taxpayers is the declining quality of service provided to them by the IRS when they seek to comply with their federal tax filing and payment obligations. As part of the IRS Restructuring and Reform Act of 1998, Congress directed the IRS “to place a greater emphasis on serving the public and meeting taxpayers’ needs.” The IRS took this directive to heart and substantially improved its taxpayer services in the aftermath of that Act. Due to a widening imbalance between the IRS’s increasing workload and its diminishing resources, however, taxpayer service levels have been declining, and in 2015, taxpayers are likely to receive the worst levels of service since the IRS implemented its current performance measures in 2001.

Analysis

The tax code as it stands today is overwhelming in its complexity and thus poses a significant compliance barrier for taxpayers, many of whom contact the IRS for assistance. In addition to publishing forms and instructions, the IRS now typically receives more than 100 million telephone calls, ten million letters, and five million visits from taxpayers each year.

The IRS reached its high-water mark in providing taxpayer service in FY 2004, when it answered 87 percent of calls from taxpayers seeking to speak with an assistor and hold times averaged 2.5 minutes, responding to a wide range of tax-law questions from taxpayers both on its toll-free lines and in its roughly 400 walk-in sites. At the same time, the IRS prepared nearly 500,000 tax returns for taxpayers who requested help, particularly low income, elderly, and disabled taxpayers, and maintained a robust outreach and education program that reached an estimated 72 million taxpayers.

By comparison, the IRS’s service expectations for FY 2015 are:

- The IRS is unlikely to answer even 50 percent of the telephone calls it receives.
- For taxpayers who manage to get through, hold times are expected to exceed 30 minutes on average and run considerably longer at peak times.
- The IRS will answer far fewer tax-law questions than it used to. During the filing season, it will not answer any questions except “basic” ones. After the filing season, *it will not answer any tax-law questions at all*, leaving the roughly 15 million taxpayers who file later in the year unable to get any answers to their questions by calling or visiting IRS offices.

- The IRS has eliminated return preparation completely.
- The IRS has reduced its training funds by 83 percent since FY 2010, leaving employees less equipped to do their jobs properly.

This performance decline results from a combination of more work and reduced resources. On the workload side, the IRS is receiving 11 percent more returns from individuals, 18 percent more returns from business entities, and 70 percent more telephone calls (through FY 2013) than a decade ago. And implementation of the Patient Protection and Affordable Care Act during the coming filing season will add a great deal of new work.

On the funding side, the IRS's budget has been reduced by about 17 percent in inflation-adjusted terms just since FY 2010. As a consequence, the IRS has already cut its workforce by nearly 12,000 employees, and it projects it will have to reduce its workforce further during FY 2015.

Like any agency, the IRS can operate more effectively and efficiently in certain areas. However, we do not see any substitute for sufficient personnel if the IRS is to provide high-quality taxpayer service. The only way the IRS can assist the tens of millions of taxpayers seeking to speak with an employee is to have enough employees to answer their calls. The only way the IRS can timely process millions of letters from taxpayers is to have enough employees to read the letters and act on them. And the only way the IRS can meet the needs of the millions of taxpayers who visit its walk-in sites is to have enough employees to staff them.

The requirement to file a tax return and pay taxes is generally the most significant burden a government imposes on its citizens. The National Taxpayer Advocate feels strongly that the government has a duty to make compliance as simple and painless as possible. We are deeply concerned that the government is largely turning its back on the significant number of taxpayers who require personal assistance in order to comply with their tax obligations.

The National Taxpayer Advocate believes Congress and the IRS have a shared responsibility to ensure that the taxpayers who pay our nation's bills receive the assistance they need. We do not think it is acceptable for the government to tell millions of taxpayers who seek help each year, in essence, "We're sorry. You're on your own."

Recommendations

The National Taxpayer Advocate recommends that Congress take the following actions: (1) in the short term, carefully monitor taxpayer service trends and ensure that the IRS receives the oversight and funding it requires to meet the needs of U.S. taxpayers, and (2) over the longer term, undertake comprehensive tax reform to reduce the complexity of the Internal Revenue Code and reduce the associated compliance burdens it imposes on taxpayers.

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

Problem

The National Taxpayer Advocate believes taxpayers have a right to expect that their government will take their telephone calls and answer their letters. The IRS agrees and included the *right to quality service* as a fundamental taxpayer right in its recent adoption of a taxpayer bill of rights. The National Taxpayer Advocate is concerned, however, that the ongoing cuts to the IRS's budget in fiscal years (FY) 2010–FY 2015 have resulted in an unacceptably poor level of taxpayer service. In response to these concerns, the Wage & Investment (W&I) Division and the Taxpayer Advocate Service (TAS) are collaborating on the development of a ranking methodology for the major taxpayer service activities offered by W&I. The new methodology will take taxpayer needs and preferences into account while balancing them against the IRS's need to conserve limited resources, thus enabling the IRS to make resource allocation decisions that will optimize the delivery of taxpayer service activities given resource constraints. But limitations imposed by the lack of available data have delayed implementation, and it is unclear whether the IRS will devote the resources necessary to complete development of the methodology.

Analysis

Since FY 2010, the IRS budget has been cut by ten percent, resulting in an ongoing erosion in taxpayer service, and culminating in a number of major cuts to taxpayer services in FY 2014. In response to these budget cuts, the IRS has come under scrutiny by the Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office (GAO), who have questioned the IRS's rationale for its budget decisions. They found that the IRS did not have a rigorous methodology for making the difficult resource allocation decisions necessitated by today's tight budget environment. W&I is collaborating with TAS to develop a ranking tool that will provide the IRS with better information to make budget allocation decisions, balancing lower cost automated service delivery against the need for personal services of some taxpayer segments, such as low income and limited English proficient taxpayers. But, some data availability issues still need to be resolved. TAS Research and W&I Research have informally agreed to conduct a trial ranking in early 2015 using 2013 data that has recently become available. At that time, the project team will identify all remaining data needs and TAS will need to negotiate an agreement with W&I to meet those needs.

Recommendation

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

MSP #3 IRS LOCAL PRESENCE: The Lack of a Cross-Functional Geographic Footprint Impedes the IRS's Ability to Improve Voluntary Compliance and Effectively Address Noncompliance

Problem

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

Analysis

While the post-RRA 98 IRS is structured around categories of taxpayers, the IRS has made no real effort to tailor service or enforcement initiatives to meet the particular needs of the taxpayers based on the geographic region in which the taxpayer is located. Failure to maintain a local presence infringes upon the taxpayer's right to quality service whereby the taxpayer has the right to receive clear and easily understandable communications from the IRS. It also infringes upon the taxpayer's right to a fair and just tax system, because the taxpayer has the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely. National "one size fits all" service and enforcement policies for each category of taxpayer and the centralization of a substantial amount of IRS activity into remote "campuses" result in the IRS not addressing the particular attributes of local taxpayer populations. Furthermore, centralized compliance initiatives may result in missed opportunities to identify and implement strategies to target locally noncompliant segments of taxpayers. The IRS can retain its national policy-making structure without losing the ability to respond to local conditions and challenges. In RRA 98, Congress did not mandate that the IRS completely eliminate its local presence. It only directed the IRS to reorganize in a taxpayer-based model.

Recommendations

The National Taxpayer Advocate recommends that the IRS reinvigorate the Local Compliance Initiative Program; introduce video-conferencing for a virtual remote office audit or office collection visit; modify batch processing procedures so that once the taxpayer has responded, the case is assigned to one employee for the duration of the case; re-staff Appeals Officers and Settlement Officers locally so that there is at least one of each position located and regularly available in every state, the District of Columbia, and Puerto Rico; re-staff local Outreach and Education positions so there is an actual presence in every state; and provide face-to face service through the use of mobile vans in each state.

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

Problem

When passing the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress expressed the desire that all taxpayers should enjoy convenient access to Appeals, regardless of their locality. Specifically, in § 3465(b) of RRA 98, Congress required the IRS to ensure that an Appeals Officer is regularly available within each state. The IRS does not appear to have responded directly to this mandate, continuing instead to rely on circuit riding as a means of providing Appeals Officers and Settlement Officers to states lacking a permanent Appeals presence. Almost one quarter of the states (12 out of 50) have no permanent Appeals presence, and this number of states lacking a permanent field office has increased by 33 percent, from nine to 12, since 2011. Additionally, the number of Appeals personnel available to ride circuit has dropped by 27 percent in recent years. Unsurprisingly, circuit riding case closures have likewise fallen in each of the last four years. The IRS's contention that convenient access to Appeals can be adequately satisfied through its system of circuit riding is not supported by the available evidence.

Analysis

Taxpayers who choose, or are compelled by circumstance, to accept a circuit riding conference are often negatively impacted. Circuit riding Appeals cases consistently take an additional six months or more to resolve than face-to-face Appeals cases conducted in permanent field offices. Further, available data indicates that appeals with face-to-face conferences held via circuit riding have significantly lower agreement rates, have substantially higher levels of disagreement, and are more likely to yield dissatisfied taxpayers than appeals with face-to-face conferences held in permanent field offices. These adverse impacts of circuit riding, which is the IRS's current means of serving states lacking a permanent Appeals presence, cause taxpayers to question the fairness and independence of the Appeals process, and result in negative downstream consequences for the IRS, such as additional litigation.

Recommendations

The National Taxpayer Advocate recommends that the IRS expand Appeals duty locations in a way that ensures that at least one Appeals Officer and one Settlement Officer are permanently stationed within every state, the District of Columbia, and Puerto Rico; and begin systematically collecting information allowing for a more precise analysis of the timeliness and fairness of Appeals conferences conducted through circuit riding both in states without a permanent Appeals presence and in states where Appeals field offices are augmented by circuit riding.

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

Problem

On January 2, 2014, the IRS ceased providing free return preparation services at the IRS local Taxpayer Assistance Centers (TACs), and directed taxpayers to use Free File, tax preparation software that is free for taxpayers whose 2013 incomes were less than \$58,000, or obtain the services at Volunteer Income Tax Assistance and Tax Counseling for the Elderly (VITA or TCE) sites. Insufficient funding combined with “out of scope” constraints, volunteer training restrictions, and tax preparation software limitations may lead to the VITA and TCE programs lacking the adequate infrastructure to meet the specific needs of underserved taxpayers, including rural, elderly, disabled, English as a second language (ESL), American Indian, and low income taxpayers. By eliminating tax preparation services at TACs and inadequately supporting VITA/TCE sites, the IRS makes it more difficult for taxpayers to get tax preparation assistance that helps them meet their reporting obligations and comply with the tax laws. These shortcomings burden taxpayers, may cause taxpayers to pay more tax than they should or seek assistance from unqualified or unscrupulous preparers, thereby undermining voluntary compliance and eroding the taxpayer’s *rights to be informed, to quality service, and to pay no more than the correct amount of tax.*

Analysis

In fiscal year (FY) 2014, VITA and TCE programs prepared 3,472,696 returns, an increase of about 27 percent over the FY 2009 level. VITA and TCE sites that received funding from the IRS, also referred to as award grantees, alone prepared more than 1.4 million and 1.3 million returns, respectively, during FY 2014. Inexplicably, the IRS awarded VITA grantees \$100,000 less than in FY 2013 and committed more resources to the TCE grant program, despite the fact that the number of returns prepared by VITA programs increased at a substantially higher rate than the number of returns prepared by TCE programs in FYs 2009-2013. Because every federal grant dollar must be matched by the VITA grantee, a requirement that is not imposed on TCE grantees, the IRS funding decisions reduced resources available to the VITA grant program by \$200,000 in FY 2014. The IRS does not capture the number of taxpayers who are turned away from VITA or TCE sites because the issues they need help with are “out of scope.” VITA and TCE sites have reported an increase in these types of returns. The Free File software cannot address these issues either. Consequently, these taxpayers have nowhere to turn for free assistance in preparing their returns.

Recommendations

The National Taxpayer Advocate recommends that the IRS increase VITA funding to maximize the overall resources (federal and matching funds) available for free tax preparation assistance; remove VITA and TCE program grant restrictions for specific tax forms, schedules, and issues, including Schedules C, D, and F, and ITINs; allow grant funding for quality review, Certifying Acceptance Agents, and year-round services at select sites; require volunteers who are authorized under Circular 230 to practice before the IRS (*i.e.*, attorneys, CPAs, and Enrolled Agents) to annually recertify only on new provisions and changes in tax law; and provide free tax preparation assistance at TACs in areas with limited access to VITA or TCE volunteers, along with proper staffing and hours to handle taxpayer traffic.

THE RIGHT TO A FAIR AND JUST TAX SYSTEM: COMPLEXITY

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

Problem

The Patient Protection and Affordable Care Act of 2009 (ACA) was enacted by Congress in 2010 to provide affordable health care coverage for all Americans. To accomplish this goal, the ACA provides targeted tax credits for low income individuals and for small businesses, while imposing a personal responsibility on individuals to have health coverage. The true test for the IRS and individual taxpayers will begin in 2015, when those filing tax year 2014 federal income tax returns will have to report that they have “minimal essential coverage” or are exempt from the responsibility to have the required coverage. The IRS has made tremendous progress implementing the healthcare provisions with limited time and resources. However, the role of the IRS is downstream in many of the reporting processes, because it receives new information returns from exchanges through the hub maintained by the Department of Health and Human Services. As a result, taxpayers and the IRS may experience problems over which the IRS has no control. However, the IRS will certainly bear much of the public blame when the problems arise in the context of return filing. Conversely, taxpayers and the IRS will experience problems created specifically by ineffective IRS processes, some of which are exacerbated by the general reduction in funding for taxpayer service.

Analysis

The Taxpayer Advocate Service has identified the following concerns about the IRS’s implementation of ACA provisions:

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

Recommendations

The National Taxpayer Advocate recommends that the IRS take the following actions: educate taxpayers early and repeatedly about the requirement to update their information throughout the year with the Exchange if they are receiving the advance PTC; for those installment agreements, partial pay installment agreements and offers in compromises including SRP liabilities, apply payments to the oldest liability first to protect the government’s best interests; reissue the current white paper addressing the IRS’s authority

to include SRP liabilities in installment agreements and offers in compromise in the form of Program Manager Technical Advice to be released to the public; include information about TAS and Low Income Taxpayer Clinics in 30-day letters that include the preliminary audit report and describe the taxpayer's appeal rights; expand the tax identification number matching program to health insurers and self-insured employers that are required to file Form 1095-B, *Health Coverage*; provide additional guidance to employers on how to calculate the number of full-time equivalents for purposes of meeting the minimum essential coverage requirements.

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

Problem

Before it updated the “streamlined” program in 2014, the IRS generally required those who failed to report offshore income and file a related information return (*e.g.*, a *Report of Foreign Bank and Financial Accounts* (FBAR)) to enter into an offshore voluntary disclosure (OVD) settlement program and pay an “offshore penalty” designed for bad actors. “Benign actors” with inadvertent violations generally had to “opt out” and be audited to obtain a lesser penalty. Uncertainty about what penalty might apply in the audit, the IRS’s one-sided interpretation of the program terms, processing delays, and the cost of representation in an audit prompted some to pay a disproportionate offshore penalty. Inside the 2011 OVD programs, taxpayers with small accounts paid over eight times the unreported tax—over ten times the 75 percent penalty for civil tax fraud—and those who were unrepresented generally paid even more.

Analysis

Because violations by taxpayers who have small accounts or are unrepresented are more likely to have been inadvertent, the OVD programs undermined the statutory scheme, which applies a higher penalty to “willful” than non-willful violations or those due to “reasonable cause.” The IRS’s one-sided interpretations of its OVD FAQs, which were not explained, appealable, or published, eroded confidence that the IRS would be reasonable in a post-opt-out examination. The IRS now allows benign actors to pay a smaller penalty under the 2014 streamlined program. However, unlike the last time it made taxpayer-favorable changes to an OVD program, the IRS will not allow those with signed closing agreements to benefit from the most recent changes, thereby punishing taxpayers who came in early. Thus, the IRS’s OVD programs eroded taxpayer rights, such as the rights to *pay no more than the correct amount of tax, challenge the IRS’s position and be heard, appeal an IRS decision in an independent forum, to be informed, and to a fair and just tax system.*

Recommendations

The IRS should improve the transparency of OVD program guidance (*e.g.*, FAQ interpretations); allow taxpayers to discuss OVD and streamlined program guidance interpretations with the IRS employee interpreting the guidance and to appeal the interpretations; and allow taxpayers to amend closing agreements to benefit from recent program changes.

MSP #8 PENALTY STUDIES: The IRS Does Not Ensure Penalties Promote Voluntary Compliance, as Recommended by Congress and Others

Problem

Over 20 years ago, Congress recommended the IRS “develop better information concerning the administration and effects of penalties” to ensure they promote voluntary tax compliance. It is the IRS’s official policy to do so, and the IRS’s stakeholders have recently echoed this recommendation. As the number of civil tax penalties has increased – from 14 in 1955 to more than 170 today – penalty analysis has become more challenging, and the IRS has done little to implement the recommendation. It has assigned responsibility for IRS-wide penalty policy to the Office of Servicewide Penalties (OSP). Over the last ten years, OSP has reviewed only one inconclusive study, and this review did not lead to any policy changes.

Analysis

The OSP, an office of six analysts buried three levels below the Small Business / Self-Employed Division Commissioner, cites insufficient resources, insufficient staffing, employees with the wrong skillsets, and a lack of access to penalty-related data as barriers to conducting penalty research. It also appears to lack the authority to implement significant IRS-wide changes. Other IRS business units do not ask OSP for substantive comments before they implement penalty initiatives or policy changes. Moreover, the IRS has not developed a plan to address these challenges, as it committed to do in 2009. As a result, some IRS penalty procedures probably discourage voluntary compliance, as studies conducted by the Taxpayer Advocate Service (TAS) have indicated.

Recommendations

The National Taxpayer Advocate recommends the IRS finalize a plan to ensure penalties promote voluntary compliance; provide OSP with the tools, training, and resources to achieve its objectives; require penalty procedures to be incorporated into the Internal Revenue Manual and substantively reviewed by OSP; direct OSP to compile, review, and consider existing penalty studies (including TAS studies) and regularly initiate new studies, in partnership with IRS and external researchers; and direct OSP to publish its analysis and conclusions.

MSP #9 COMPLEXITY: The IRS Does Not Report on Tax Complexity as Required by Law**Problem**

The IRS Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to report to Congress each year on the sources of and ways to reduce complexity in tax administration. However, the IRS has issued only two such reports and none since 2002. Congress adopted legislation to address each area of complexity referenced in the reports, and the IRS addressed the administrative problems they uncovered. Thus, the IRS's decision to discontinue the reports has likely contributed to tax complexity.

Analysis

The complexity of the tax code, which has reached nearly four million words, continues to burden taxpayers and drain IRS resources. For 2007, the IRS estimated the compliance burden for the median individual taxpayer (as measured by income) was \$258. While these short reports, which addressed only three issues each, would require some resources to produce, these costs pale in comparison to the costs of complexity. The reports could help Congress and the IRS identify discrete changes that would reduce complexity without large-scale tax reform. Moreover, if the reports prompt a reduction in complexity, they might ultimately help the IRS do its job and reduce the cost of administering the tax code, while improving voluntary compliance and bringing in more revenue. They could also help implement the taxpayer rights *to be informed* (e.g., know and understand how to comply), *to quality service* (e.g., to receive clear and easily understandable communications from the IRS), and *to a fair and just tax system*.

Recommendation

The IRS should produce annual complexity reports, as required by law. These reports should address complexity faced by different taxpayer segments (one segment per year; individuals, small businesses, etc.) so that they cover the entire tax system.

MSP #10 COMPLEXITY: The IRS Has No Process to Ensure Front-Line Technical Experts Discuss Legislation with the Tax Writing Committees as Requested by Congress**Problem**

Pursuant to RRA 98 section 4012, the tax-writing committees in Congress should hear from “front-line technical experts” at the IRS about the “administrability” of pending amendments to the tax code. Employees who regularly communicate with taxpayers probably have a clear and pragmatic understanding of the challenges facing both taxpayers and front-line IRS employees. If it were easier for Congress to consult with these front-line technical experts, then Congress might be more likely to do so before finalizing legislation, and the laws would probably be simpler, less burdensome, more taxpayer-focused, and easier to administer. If such information empowered Congress to write tax laws that are more fair or easier to understand and administer, it would also promote the taxpayer *rights to a fair and just tax system* and *to quality service*.

Analysis

The IRS has no process to automatically identify front-line technical experts for Congress or to provide Congress with an opportunity to discuss the administrability of pending (or current) legislation with them. When the IRS Office of Legislative Affairs receives a request to comment on pending legislation, it generally seeks the views of the business operating divisions (BODs), which do not always consult with front-line technical experts. In other words, the IRS does not automatically seek the views of front-line technical experts, except as needed on a case-by-case basis. Nor does it ask to bring them before Congress or even identify them for Congress.

Recommendation

The IRS should establish a process by which it automatically identifies specific front-line technical experts who can discuss the administrability of pending (or existing) legislation directly with the tax writing committees, as provided by RRA 98 section 4021.

MSP #11 WORKLOAD SELECTION: The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy

Problem

Sixteen years after the National Commission for Restructuring the IRS directed the IRS to select returns to audit on the basis of research—which for tax administration today means applied social science research about taxpayer behavior—the IRS continues to base its compliance initiatives, including audit selection, primarily on tax data. The IRS claims to recognize the value of a holistic approach to encouraging compliance, but does not seek the data it needs to develop an approach based on applied and behavioral research. Without a more expansive definition of research to drive initiatives, and without using pilots and surveys to test and evaluate these programs before implementing them, IRS compliance initiatives will not drive future compliance. Audit selection will continue to be only a tactic, rather than part of an overall compliance strategy.

Analysis

An effective compliance strategy must be based on various types of data—numeric, return-based, geographic, demographic, socio-demographic, and psychographic—as well as the impact of tax morale and the impact of perceptions of fairness on tax compliance. It should incorporate not only audits but also education and outreach that leverage partner relationships, and it should include an effective communication strategy.

Recommendations

The National Taxpayer Advocate recommends that the IRS adopt increasing voluntary compliance as the primary measure for evaluating both enforcement and taxpayer service initiatives. It should not only incorporate applied and behavioral research into all of its compliance initiatives, but should also fund or activate compliance initiatives only after adopting an integrated strategy. Such a strategy should articulate how the IRS will use education, outreach, partners, assistance, non-invasive compliance contacts, and enforcement to increase compliance. The strategy should describe how the IRS will test compliance initiatives before they are fully deployed and use tests or pilots to project their effect on future compliance. The strategy should explain how the IRS will measure the initiative's success, including the use of surveys and focus groups, and adjust its overall compliance plan in the light of continuing research findings and trends.

THE RIGHT TO BE INFORMED: ACCESS TO THE IRS

MSP #12 ACCESS TO THE IRS: Taxpayers Are Unable to Navigate the IRS and Reach the Right Person to Resolve Their Tax Issues

Problem

Taxpayers very often face difficulty in reaching the right person at the IRS to resolve their problems. The IRS Restructuring and Reform Act of 1998 (RRA 98) requires the IRS to make itself accessible to taxpayers, specifically by phone. However, calling local offices does little good because the IRS does not answer these calls. Taxpayers also encounter problems in reaching the right person on the IRS's nationwide toll-free line, where callers must navigate an extended phone tree without being given the option to speak to a live person. The IRS has failed to embrace current technology that would allow it to comply with the intent of the RRA 98 provisions—ensuring taxpayers can reach the person at the IRS who can answer their questions or help with their problem. When taxpayers cannot speak to someone at their local IRS office, or find the right person to talk to, their *right to quality service* is compromised.

Analysis

Section 3709 of RRA 98 mandates that the IRS place the addresses and telephone numbers for local offices in local phone directories. However, these local listings are not helpful because the IRS does not answer the phone at its local offices, or even allow taxpayers (including the elderly and disabled) to leave messages. Phone books list only the main line for each local office and do not include numbers for specific functions such as the local Appeals, Examination, or Collection office. Taxpayers calling the main toll-free phone line may never reach a live person, and when they do, that employee may not be able to assist the taxpayer with his or her specific issue. The IRS already has a phone directory that provides tax practitioners with the numbers of key offices in their states, but this is not available to the public. The IRS's phone system fails to incorporate useful aspects of "311" systems, which use a combination of intelligent automation, live interaction, and an in-depth information database to address some calls, and transfer others to the appropriate department or agency.

Recommendations

The National Taxpayer Advocate recommends that the IRS provide an option for taxpayers calling local Taxpayer Assistance Center (TAC) lines to speak to a live person or be transferred to another part of the IRS; provide a phone line for elderly or disabled taxpayers to call to make an appointment at a TAC, including messaging and callback service, and establish and publicize timeframes within which callbacks must occur; make the IRS Telephone Directory for Practitioners or a similar directory available to the public; and institute a system similar to a 311 system where an operator can transfer a taxpayer to the specific IRS office that handles that person's issue or case.

MSP #13 CORRESPONDENCE EXAMINATION: The IRS Has Overlooked the Congressional Mandate to Assign a Specific Employee to Correspondence Examination Cases, Thereby Harming Taxpayers

Problem

In the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress intended for the IRS to assign one employee to each taxpayer case, to the extent practicable and when advantageous to the taxpayer. Some IRS functions provide one employee to each case, but others have overlooked or simply ignored this mandate. For example, the Correspondence Examination program, which is used in about 75 percent of individual audits, has no system or procedures for determining when a taxpayer should have one employee assigned to a correspondence exam. Nor has the IRS conducted any research to determine the downstream costs to it or the taxpayer when cases are not assigned to one employee. The IRS's failure to provide an assigned employee, as well as the associated consequences imposed on the taxpayer, violate the taxpayer's *rights to quality service, to be informed, to challenge the IRS's position and be heard, and to pay no more than the correct amount of tax.*

Analysis

Because automation allows the IRS to resolve taxpayer accounts efficiently, the assignment of one employee may not always be practicable or advantageous to the taxpayer. In correspondence exam, however, the National Taxpayer Advocate and other stakeholders, including practitioners, have long cited problems that can occur when one employee is not assigned to each case. For instance, when a taxpayer calls to inquire about a correspondence audit, IRS systems automatically route the call to the next available examiner, who is not necessarily the one working on the case. The inability to contact the employee actually handling the case creates confusion for the taxpayer and a duplication of efforts for both the taxpayer and the IRS. Sixty-two percent, or nearly two-thirds, of calls to the correspondence exam unit are repeat calls from taxpayers, which may indicate they have not been able to get their questions answered, ascertain the status of their case, or have received inconsistent information and service from one employee to the next. Those who cannot resolve their cases through the audit process must turn to other avenues such as the IRS Office of Appeals, audit reconsideration, Tax Court, and TAS.

Recommendations

The National Taxpayer Advocate recommends that the IRS analyze the additional work caused by the current approach in correspondence exam, and based on that review, develop procedures and staffing models to assign cases to one employee once the taxpayer has contacted the IRS; allow the taxpayer to individually choose service options to his or her advantage, such as leaving a voicemail for the employee owning the case or speaking with the next person available; design extension routing capabilities to enable taxpayers to reach the employees assigned to their cases; and include an option for single employee assignment in all technology developments, including virtual service delivery.

MSP #14 **AUDIT NOTICES: The IRS’s Failure to Include Employee Contact Information on Audit Notices Impedes Case Resolution and Erodes Employee Accountability**

Problem

In Section 3705(a) of the IRS Restructuring and Reform Act of 1998 (RRA 98) Congress required the IRS to include the name, telephone number, and unique employee identification number in any “manually generated correspondence.” The IRS has failed to meaningfully implement the requirements of § 3705(a) as it does not include useful specific employee contact information on most computer-generated notices, even when a particular employee has worked on the case. Campus correspondence procedures fail to address Congress’ concerns regarding the inability of taxpayers to contact an IRS employee who is knowledgeable about and accountable for the case. This situation erodes several essential taxpayer rights—*the right to quality service, the right to be informed, and the right to a fair and just tax system*—articulated in the Taxpayer Bill of Rights.

Analysis

Following the enactment of RRA 98, the IRS Office of Legislative Affairs tracked all actions the IRS took to comply with the implementation of the law. The IRS reports it took 57 actions related to § 3705 of RRA 98, but none involved a comprehensive review of correspondence to determine which notices should be considered manually generated and contain employee contact information. Nor did the IRS seek an official legal opinion from the Office of Chief Counsel regarding the requirement to include contact information on manually generated notices. Failing to take even these basic steps to ensure compliance with § 3705(a), the IRS has not addressed the concerns that Congress and other stakeholders raised leading up to RRA 98, namely access to employees who are both knowledgeable about and accountable for the actions taken on taxpayer cases.

Recommendations

The IRS should review all audit notices and correspondence, including those generated by Examination software, to ensure compliance with § 3705(a) of RRA 98; include employee contact information on any letters generated as a result of employee review of a case even if the letter is generated with the assistance of automated systems or software; include contact information for a manager on notices that have legal impact on a taxpayer, such as a Statutory Notice of Deficiency, even where such notices have been generated automatically without employee review to facilitate call-routing and case assignment; and include specific employee contact information on notices generated as a result of an employee reviewing taxpayer correspondence or answering a taxpayer call.

MSP #15 VIRTUAL SERVICE DELIVERY: Despite a Congressional Directive, the IRS Has Not Maximized the Appropriate Use of Videoconferencing and Similar Technologies to Enhance Taxpayer Services

Problem

As an element of the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress recognized that videoconferencing and similar technologies present opportunities for effective tax administration. Virtual service delivery (VSD) is an indispensable means of facilitating important taxpayer rights such as *the right to quality service, the right to challenge the IRS's position and be heard, and the right to a fair and just tax system*. Without access to VSD, taxpayers in remote areas and in states where no Examination, Collection, or Appeals or Settlement Officers are present have limited options for obtaining face-to-face interactions with IRS personnel. Notwithstanding the insights of the IRS Restructuring Commission, the directives of RRA 98, and the successes of other agencies, the IRS is still operating as a 20th century business, primarily relying on postal correspondence, telephone conversations, and taxpayer visits to brick and mortar locations.

Analysis

Societal comfort with computer technology in general, and VSD in particular, has grown significantly. Many taxpayers would embrace this option, especially if it saved them time or expense. For example, 83 percent of taxpayers responding to a study by the IRS Oversight Board indicated they were likely to use the IRS website, while 72 percent said they likely would use email to send questions directly to the IRS. Despite positive initial results, however, the IRS, due to security, personnel, and funding challenges, has not moved substantially beyond the piloting phase of VSD. The expanded availability of VSD in public locations is particularly essential for taxpayer populations that do not have access to home computer technology or who are not proficient in its use. Moreover, taxpayer digital communications (TDC), which has the potential for revolutionizing tax administration, and which would allow a wide range of interactions with the IRS over the Internet, remains in its conceptual stages.

Recommendations

The National Taxpayer Advocate recommends that the IRS maximize the benefits of VSD in brick and mortar locations currently equipped for videoconferencing by offering VSD services from all such facilities on a day-to-day basis and enhancing the scope of activities that taxpayers can undertake in conjunction with videoconferencing; establish development and implementation of TDC as one of its highest ongoing priorities; develop and publish a definitive plan for the continued rollout of both VSD in brick and mortar locations, including non-IRS facilities, and TDC, and articulate concrete dates for implementation at different stages; and allocate funding, or seek funding from Congress, sufficient to enable continued implementation of VSD initiatives in brick and mortar locations and over the Internet.

THE RIGHT TO BE INFORMED: ADEQUATE EXPLANATIONS

MSP #16 MATH ERROR NOTICES: The IRS Does Not Clearly Explain Math Error Adjustments, Making it Difficult for Taxpayers to Understand and Exercise Their Rights

Problem

Under Internal Revenue Code (IRC) § 6213(b) and (g), the IRS is authorized, in specific instances, to assess tax without first issuing the Statutory Notice of Deficiency that allows taxpayers access to the prepayment forum of the U.S. Tax Court. Previously this provision applied only to mathematical errors. In 1976, Congress expanded math errors to include “clerical errors” (*e.g.*, inconsistent entries). Congress directed that when the IRS makes an assessment for a mathematical error, the taxpayer must be given an explanation of the adjustment, which is critical to the taxpayer’s ability to challenge the adjustment and preserve his or her right to petition the U.S. Tax Court by requesting abatement within 60 days of the notice being sent. Nearly four decades since Congress provided such a directive, the explanations are often unclear, complex, and leave taxpayers confused. This makes it difficult for taxpayers to determine what, specifically, has been corrected on their returns and whether they should accept the adjustment or request a correction.

Analysis

Between January 1, 2014 and December 4, 2014, the IRS sent out 2,717,208 math error notices to individual taxpayers. When any of these explanations are vague or confusing, a taxpayer’s *right to challenge the IRS’s position and be heard* is compromised because the taxpayer may be unable to effectively raise objections and provide additional documentation in response to an IRS proposed adjustment. Unclear explanations may also undermine the taxpayer’s *right to be informed*, which includes the ability to know what is required to comply with tax laws. The Treasury Inspector General for Tax Administration found that about 50 percent of the letters and 66 percent of the notices it reviewed were determined not to be clearly written or did not provide sufficient information. If notices are not simple and clear, taxpayers cannot understand the rationale for the change to their returns and fail to request abatement within 60 days, thereby forfeiting their opportunity to contest the assessment in U.S. Tax Court. With the President’s budget proposal for fiscal year 2015 recommending creation of an entirely new category called “correctable errors,” the need to live up to the original congressional directive regarding clear explanations of adjustments becomes even more critical, because more taxpayers may become subject to the summary assessment procedures.

Recommendations

The National Taxpayer Advocate recommends that the IRS: organize a team, which would include TAS, to review all current explanations of math error adjustments, and rewrite where necessary, to ensure the congressional directive is being met; set forth an IRM template for non-standard math error adjustment explanations that provides an outline of the elements to be included in the explanation, with examples; and update math error notices to clearly disclose that the taxpayer may request abatement without providing an explanation or substantiating documentation.

MSP #17 NOTICES: Refund Disallowance Notices Do Not Provide Adequate Explanations

Problem

The IRS is not providing taxpayers with adequate explanations as to why it is disallowing their refund claims as required by Section 3505 of the IRS Restructuring and Reform Act of 1998 (RRA 98). Some IRS notices include an explanation that is too short or too vague for the taxpayer to learn the specific reasons for the disallowance. Other explanations are not written in language the taxpayer can easily understand. Some letters provide no explanation or reason at all, other than stating there is no basis for the IRS to allow the claim, or that another notice explaining the disallowance is forthcoming. A taxpayer's *right to challenge the IRS's position and be heard* means taxpayers have the right to raise objections and provide additional documentation in response to formal IRS actions. Without an adequate explanation of its actions, taxpayers cannot respond appropriately to the IRS and challenge the disallowance.

Analysis

TAS analyzed a sample of statutory notices of claim disallowance, which the IRS sends by certified or registered mail and therefore starts the running of the two-year statute of limitations period for filing a refund suit. TAS found the majority of these notices did not provide explanations that would satisfy the purpose of RRA 98 Section 3505. The insufficiencies ranged from confusing, incomplete, and misleading statements of the law, to providing incorrect amounts of the claim, to failing to state what was disallowed. In some cases, the taxpayer never receives a statutory notice of claim disallowance because the IRS requests the taxpayer waive the right to receive one without explaining the significance of the waiver. In cases where the taxpayer has already received a statutory notice of disallowance, the IRS Office of Appeals issues notices of disallowance that do not provide a reason for the disallowance at all, even though the disallowance may have been based on different grounds than that which gave rise to the statutory notice of claim disallowance at the audit level.

Recommendations

The National Taxpayer Advocate recommends that the IRS issue a stand-alone statutory notice of claim disallowance in all cases where the taxpayer does not waive the right to receive one; maintain copies of all refund disallowance notices on an electronic database that employees can easily access; revise Letter 569 (SC) to clearly explain a taxpayer's right to challenge the disallowance in court and the consequences of waiving the right to receive the statutory notice of claim disallowance; revise Form 2297, *Waiver of Statutory Notice of Claim Disallowance*, to include further information about the taxpayer's right to appeal, including the court where the taxpayer may file suit, and a statement that this is the taxpayer's only opportunity to challenge the disallowance in court; require all letters or notices stating that a claim for refund is being partially or fully disallowed, regardless of whether they start the running of the statute of limitations on filing suit, to explain the specific reasons for the disallowance; provide training to all employees who create notices of claim disallowance and No Consideration letters to reinforce the requirement to provide an explanation of the specific reasons for the disallowance; require all notices of claim disallowance and No Consideration letters to include the amount of the claim; require all notices of claim disallowance where the reason for disallowance is the expiration of the refund statute of limitations to include the date the return was deemed filed, how the IRS calculated that date, and the date the claim was due; require "No Consideration" letters to include an explanation of the specific reason for the disallowance, and if supporting documentation was not accepted, an explanation of why and what the taxpayer can do to cure the claim; and for notices of disallowance where the taxpayer can challenge the refund disallowance in court, provide details similar to those in Letter 5087C, including where to find more information about filing refund suits.

THE RIGHTS TO PRIVACY AND TO A FAIR AND JUST TAX SYSTEM

MSP #18 **COLLECTION DUE PROCESS: The IRS Needs Specific Procedures for Performing the Collection Due Process Balancing Test to Enhance Taxpayer Protections**

Problem

Congress intended the IRS to provide meaningful Collection Due Process (CDP) hearings to taxpayers, weighing their concerns that any collection action be *no more intrusive than necessary* against the government's need for the efficient collection of taxes. This balancing test is central to a CDP hearing because it instills a genuine notion of fairness into the process from the perspective of the taxpayer. The balancing test also validates the taxpayer's *right to privacy* by taking into account the invasiveness of enforcement actions and the due process rights of the taxpayer. A TAS review of CDP procedures and case law reveals the IRS Office of Appeals is not giving proper attention to the balancing test, especially to legitimate concerns of taxpayers regarding the intrusiveness of the proposed collection action. Instead, Appeals often uses *pro forma* statements (without elaboration or proper analysis) that the balancing test has been performed. These issues contribute to the appearance that Appeals is simply "rubber stamping" prior determinations by the Collection function. By not applying the balancing test consistently, the IRS is missing opportunities to improve compliance, enhance taxpayer trust and confidence, relieve undue burden on taxpayers, and lend true meaning to the Taxpayer Bill of Rights (TBOR). The lack of detailed and specific procedures describing how to conduct the balancing test, along with inadequate training on how to apply such a test, undermines the congressional intent to enhance taxpayer protections through CDP hearings, and erodes core taxpayer rights.

Analysis

TAS's analysis of Appeals' Internal Revenue Manual (IRM) provisions reveals a lack of guidance about specific factors to consider when applying the balancing test. As a result, the IRS does not give the test proper emphasis as intended by Congress in the IRS Restructuring and Reform Act of 1998 (RRA 98). TAS's review of CDP case law found that in the majority of cases, Appeals made a *pro forma* or boilerplate determination, avoiding any analysis of balancing factors. Appeals relied instead on the abuse of discretion standard of judicial review, which is deferential to the government. A few court opinions elaborated on the factors to consider in conducting the balancing test, which could be a starting point for the IRS in developing proper procedures.

Recommendations

The National Taxpayer Advocate recommends that the IRS, in collaboration with TAS, formulate a policy statement on the CDP balancing test based on congressional intent; in collaboration with TAS, develop specific factors for application of the test based on an analysis of case law and legislative history for use by both Appeals and Collection; revise the IRM to specifically prohibit *pro forma* statements that the balancing test has been performed and require a description of what factors were considered and how they apply in the particular taxpayer's case; integrate any newly developed factors for the application of the CDP balancing test into the Appeals IRM and train all Appeals Officers, Settlement Officers and Appeals Account Resolution Specialists on applying the test consistently; and incorporate balancing test analysis into the Collection IRM while providing necessary training to Collection employees.

MSP #19 FEDERAL PAYMENT LEVY PROGRAM: Despite Some Planned Improvements, Taxpayers Experiencing Economic Hardship Continue to Be Harmed by the Federal Payment Levy Program

Problem

The Federal Payment Levy Program (FPLP) is an automated system the IRS uses to match its records against those of the government's Bureau of the Fiscal Service (BFS) to identify taxpayers with unpaid tax liabilities who receive certain payments from the federal government. Internal Revenue Code (IRC) § 6331 allows the IRS to issue continuous levies for up to 15 percent of federal payments due to these taxpayers who have unpaid federal liabilities. In January 2011, the IRS began applying a low income filter (LIF) to the FPLP to screen out low income taxpayers whose incomes are below 250 percent of the federal poverty level and who may experience economic hardship due to a levy on their Social Security old age or disability benefits, or Railroad Retirement Board benefits. However, under current LIF exclusion criteria, low income taxpayers who have accounts with an unfiled delinquent tax return indicator (*i.e.*, a tax delinquency investigation (TDI) indicator), will bypass the LIF and be subject to the FPLP. Excluding these taxpayers from the LIF and failing to consider their financial circumstances is contrary to the IRS's own pre-levy determination guidance, which requires employees to consider hardship before issuing a levy. When the IRS fails to consider taxpayers' financial circumstances by having them bypass the LIF, it undermines their *right to privacy* and their *right to a fair and just tax system*.

Analysis

In fiscal year (FY) 2014, 30,177 taxpayers whose income fell below 250 percent of the federal poverty level were subjected to the FPLP because the IRS bypassed the LIF. The median income for these taxpayers was \$17,515, far below 250 percent of the 2014 federal poverty level of \$29,175 for a single person. The IRS records that indicate an unfiled return are not always accurate. In fact, of all the accounts that had a TDI indicator, 21 percent did not actually have a delinquent return. Because 21 percent of returns with a TDI code actually are not nonfilers or owe little to no tax, the TDI indicator is not a reliable way to identify those who have unfiled returns on their account. The IRS argues filed returns are crucial to accurately determine if the taxpayer meets criteria for being filtered out of the FPLP (*i.e.*, did their income fall below 250 percent of the federal poverty level). However, the argument that the IRS cannot determine a taxpayer's income level without a filed return is unsound, because the IRS generally has third-party information on taxpayers and already relies on such information in certain circumstances to reconstruct returns or make the TDI determination in the first place. Therefore, the IRS's claim that it cannot determine a taxpayer's income level without a filed return is belied by its own reliance on that information.

Recommendations

The National Taxpayer Advocate recommends the IRS eliminate the LIF exclusion for unfiled returns; expedite programming to exclude from the FPLP any taxpayers receiving Social Security Disability Insurance payments; and in collaboration with TAS, review the FPLP program requirements and ensure the correct taxpayers are bypassing the LIF.

MSP #20 OFFERS IN COMPROMISE: Despite Congressional Actions, the IRS Has Failed to Realize the Potential of Offers in Compromise

Problem

With the passage of RRA 98, Congress intended for the IRS to adopt a flexible use policy for the offer in compromise (OIC) program in order to provide a collection alternative to struggling taxpayers. Specifically, Congress introduced the concept of effective tax administration (ETA) offers with the hope that the IRS would take into consideration factors such as equity and public policy when compromising a liability. Despite the many benefits that derive from OICs, the IRS has not developed practices that facilitate flexible use of the OIC program. IRS procedures particularly burden taxpayers who submit non-hardship ETA offers on behalf of businesses. These taxpayers often face the hurdle of proving that they will not receive a financial advantage over other businesses if their offer is accepted. Under current OIC practices, the IRS is not only gradually losing the ability to collect any revenue on aging collection inventory, but is denying taxpayers a timely resolution of their tax problems, thereby violating the taxpayer's *right to finality*. Additionally, when the IRS unreasonably denies an OIC and resumes collection activity, it may violate the taxpayer's *right to privacy*, which ensures that any IRS enforcement action be no more intrusive than necessary. Lastly, the IRS approach to OICs may deny offers to eligible taxpayers by not considering all the facts and circumstances affecting an underlying liability, thereby undermining the *right to a fair and just tax system* and harming future compliance.

Analysis

In fiscal year (FY) 2014, the IRS received 66,155 offers and accepted 26,924. The number of accepted offers decreased approximately 13 percent compared to FY 2013, when the IRS received 71,644 new offers and accepted 30,840 offers. OIC staffing decreased approximately 9 percent between 2007 and 2014, notwithstanding a 62 percent increase in processable OIC receipts during the same period. As a result of reduced resources, the IRS also relies on the Queue, currently not collectible status (CNC), and "shelving" to hold accounts indefinitely instead of settling the debt in the OIC program. As of September 30, 2014, the Queue and Shelved status held 4,874,747 taxpayer delinquent accounts (TDA) worth approximately \$66 billion. By not taking a flexible approach to OICs, including the underutilization of ETA offers for both individual and business taxpayers, the IRS is not only overlooking Congress's mandate to effectively use the OIC, but also is missing opportunities to improve compliance, collect revenue, and support the nation's economy.

Recommendations

The National Taxpayer Advocate recommends that the IRS increase staffing in the OIC program to 2001 levels and ensure sufficient employees are trained to evaluate complex offers; expand use of the ETA offer for individual and business taxpayers with an emphasis on flexibility in evaluation of the taxpayer's circumstances; proactively identify cases that would be viable candidates for offers and reach out to those taxpayers prior to placing accounts in CNC status, into the Queue, or shelved status; increase the information and training about the OIC program to Automated Collection System employees and share more information to the Stakeholder Partnerships, Education and Communication unit, the Low Income Taxpayer Clinics, and the Volunteer Income Tax Assistance program; revise the IRM to remove the economic competition argument, as it is irrelevant and violates the taxpayer right to a fair and just tax system; and in the case of non-economic hardship ETA offers, if the IRS persists in requiring the subjective assessment of whether other taxpayers would view the compromise as a fair and equitable result, it should revise its procedures to have the National Taxpayer Advocate, as the voice of taxpayers within the IRS, determine whether other taxpayers would view the compromise as fair and equitable.

MSP #21 OFFERS IN COMPROMISE: The IRS Does Not Comply with the Law Regarding Victims of Payroll Service Provider Failure

Problem

Outsourcing payroll and related tax duties to payroll service providers (PSPs) is a common business practice, especially for small business owners. However, if a PSP mismanages or embezzles funds that should have been paid to the IRS or state tax agency, the client employer will remain responsible for unpaid tax, interest, and penalties, effectively (from the employer's perspective) paying the tax twice – once to the failed PSP, and again to the IRS. Congress recently enacted legislation that incorporates two recommendations made by the National Taxpayer Advocate over the years and requires the IRS to: (1) issue notices to both the employer and the PSP when either party requests an address change; and (2) give special consideration to an offer in compromise (OIC) request from a victim of fraud or bankruptcy by a third-party payroll tax preparer. The National Taxpayer Advocate will monitor the process to ensure the IRS is on track to issue the dual notices by the date promised, and has concerns about how the IRS will implement its recently issued guidance on processing OICs submitted by victims of PSPs.

Analysis

Congress granted the IRS the flexibility to consider all of the circumstances that led to a delinquency when evaluating an OIC. The IRS can accept offers even if it could achieve full collection when such collection would create an economic hardship for the taxpayer or when “compelling public policy or equity considerations” are identified by the taxpayer. In practice, the IRS has not embraced its Effective Tax Administration (ETA) OIC authority and has consistently underutilized this tool to provide relief to victims. The IRS does not track the number of PSP victims, but even considering only the approximately 500 to 600 employers impacted by the recent AccuPay bankruptcy, accepting 54 non-economic hardship ETA offers over the past two years is hardly the “flexible” use Congress intended. One obstacle to more acceptances is IRS interim guidance inappropriately instructing Collection employees to assess whether an accepted offer would be perceived as fair and equitable by the community. Such an approach could result in taxpayers who have tried to fully comply with their employment tax obligations being forced to pay that amount twice, leading to significant economic harm for the business. The correct, relevant inquiries are whether the taxpayer exercised good judgment in using this particular PSP, timely paid the payroll taxes and withholding to the PSP, and took appropriate steps to mitigate its loss (including paying over any insurance proceeds received because of the loss).

Recommendations

The National Taxpayer Advocate recommends that the IRS amend its interim guidance and Internal Revenue Manual (IRM) to incorporate the changes suggested by the National Taxpayer Advocate; develop and deliver comprehensive training to all Revenue Officers and Centralized OIC employees on the new guidance for reviewing and processing ETA OICs submitted by victims of PSP failure; and update the IRM to instruct Revenue Officers to forward OICs submitted by PSP victims to the centralized OIC group without delay.

MSP #22 **MANAGERIAL APPROVAL FOR LIENS: The IRS's Administrative Approval Process for Notices of Federal Tax Lien Circumvents Key Taxpayer Protections in RRA 98**

Problem

One of the IRS's most significant powers is its authority to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes. The NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders. Unlike most other creditors, the IRS does not need a judgment from a court to file an NFTL. When properly applied, lien authority can be an effective tax collection tool. However, when improperly applied, NFTLs can needlessly harm a taxpayer's creditworthiness and undermine long-term tax collection. In § 3421 of the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress required the IRS to adopt procedures in which an employee's determination to file an NFTL would, "where appropriate," be approved by a supervisor, with disciplinary actions for failing to obtain this approval. However, the IRS has made virtually no adjustments to its procedures along the lines of what Congress directed. Flipping Congress' intent on its head, the IRS in many cases requires employees to obtain managerial approval if they determine *not* to file or defer filing an NFTL. The IRS's decision to ignore a congressional directive and rely on a broad NFTL filing policy compromises a taxpayer's *rights to privacy* and *to a fair and just tax system*.

Analysis

Congress enacted § 3421 of RRA 98 to preclude the IRS from "abusively us[ing]" its liens-and-seizure authority. However, the IRS instead chose to adopt an even broader NFTL filing policy. Several significant Taxpayer Advocate Service research studies show this approach is ineffective in collecting revenue, impairs payment compliance and the taxpayer's earnings, and is particularly harmful to taxpayers whose accounts the IRS has classified "currently not collectible" (CNC) because of economic hardship. In response to this research, the IRS did implement initiatives that led to a 51 percent decline in NFTL filings, from about 1,096,376 in FY 2010 to 535,580 in FY 2014. If the filing of NFTLs were a significant driver of revenue collection, one would expect this dramatic decline to produce a similarly dramatic decline in revenue collected on delinquent accounts. Yet the percent of dollars collected on delinquent accounts by the IRS Collection function has not shown a similar decrease, even though the dollars available for collection decreased slightly from FY 2010 to FY 2014.

Recommendations

The National Taxpayer Advocate recommends that the IRS, in collaboration with TAS, develop and implement factors to determine situations in which managerial approval of NFTL filings is appropriate and should be required; and establish disciplinary actions to be taken when managerial approval prior to filing a NFTL is not secured in the specified situations.

MSP #23 STATUTORY NOTICES OF DEFICIENCY: Statutory Notices of Deficiency Do Not Include Local Taxpayer Advocate Office Contact Information on the Face of the Notices

Problem

Section 1102(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) provides that statutory notices of deficiency (SNODs) “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.” However, our review of existing IRS statutory notices of deficiency found that more than half, or eleven out of 17, types of SNODs fail to comply with the statutory requirements and instead include this information in a “stuffer” or insert. Congress enacted this provision of RRA 98 to ensure that taxpayers are aware of their right to contact the local office of the Taxpayer Advocate Service (TAS) at a crucial point in their tax controversy. While these notices are still valid, the failure of the IRS to comply with the requirements harms taxpayers and violates the taxpayer’s *right to a fair and just tax system*.

Analysis

By requiring the IRS to include the local office contact information on the SNOD, Congress wanted taxpayers to know that they have the right to go to the local office of TAS to receive assistance. Congress was very clear that it did not intend the IRS to merely give out a national contact number for the Taxpayer Advocate Service. The Conference Report also provided further clarification by stating that the IRS should publish the information “on” the SNOD, as opposed to “with” the notice. The taxpayer’s receipt of a SNOD is a critical point in the audit or appeals process. The taxpayer needs information about what he or she must do to protect the right to an independent review of the proposed deficiency prior to assessment. Taxpayer awareness of the Local Taxpayer Advocate office within their community is even more important today, when so much of the IRS is centralized and remote from the taxpayer and the IRS is limiting its geographically-based interaction with taxpayers. Case advocates at the local TAS offices are trained to inform taxpayers of their rights and options once they receive a SNOD. Most importantly, the local office can resolve some of the fear and mystery of the tax controversy process, especially with regard to petitioning the Tax Court.

Recommendations

The National Taxpayer Advocate recommends that the IRS evaluate every SNOD to determine which ones comply with RRA 98; in conjunction with the National Taxpayer Advocate, develop an agreed-upon set of rules and language to appear on each SNOD; revise all SNODs not in full compliance with RRA 98 to include the taxpayer’s right to contact TAS and the name and telephone number of the local office on the face of the notice in a way that is consistent with how TAS aligns taxpayers to local offices; and require all employees involved in issuing SNODs or answering incoming calls about them to take technical training developed by TAS on issues including SNOD rescission and the taxpayers’ rights to file a petition in the U.S. Tax Court and to contact their LTAs.

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 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 considers a taxpayer perspective.

TAXPAYER BILL OF RIGHTS

LR #1 TAXPAYER RIGHTS: Codify the Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections

Problem

The Internal Revenue Code provides dozens of real and substantive rights that protect taxpayers from unfair and unjust treatment and enable them to challenge arbitrary and capricious government actions. However, taxpayers may not take advantage of their rights because they are not aware of them. Although the IRS has adopted a Taxpayer Bill of Rights (TBOR), there is no general statement of core taxpayer rights and responsibilities in the Internal Revenue Code. Furthermore, the specific statutory rights that give effect to the TBOR need to be updated and expanded to protect taxpayers further. Since the IRS Restructuring and Reform Act of 1998 was passed over 16 years ago, there has been no major taxpayer protection legislation passed by both houses of Congress.

Analysis

A 2012 survey found less than half of all U.S. taxpayers believe they have rights before the IRS, and only 11 percent said they knew what those rights are. Taxpayers have no simple way to identify or locate rights in the Code because they are scattered throughout its various sections. It is even more difficult for taxpayers to find “off-code” provisions in different pieces of legislation. Some specific rights contain gaps in coverage and fail to protect taxpayers in all appropriate situations. Rights also become diluted over time when they are not updated to reflect the current environment or fine-tuned to account for changes in tax administration. Another reason rights become ineffective is the lack of an enforceable remedy for violations. In some cases, specific taxpayer protections are not effective because they are based on administrative practice instead of a statutory direction, and thus are subject to change. Finally, a major reason specific rights are impaired is that the IRS fails to properly implement and protect them. Once rights are enacted, the IRS will be severely hampered in its ability to implement new policies, procedures, and systems necessary for protecting taxpayer rights if it does not receive adequate funding. In addition, if the IRS is not monitored regularly, the rights may erode over time.

Recommendation

The National Taxpayer Advocate recommends that Congress codify the Taxpayer Bill of Rights that sets forth the fundamental rights and obligations of U.S. taxpayers; enact past legislative recommendations as well as those from this year’s Annual Report that relate to each of the core taxpayer rights; provide an appropriate level of funding for the IRS so it can properly undertake, implement, and train its employees about taxpayer rights provisions; and require annual joint oversight hearings to help identify and address problem areas, with specific focus on how the IRS is meeting the needs of particular taxpayer segments, including individuals, small businesses, and exempt organizations, and how it is protecting taxpayer rights.

THE RIGHT TO QUALITY SERVICE

LR #2 **ACCESS TO APPEALS: Require that Appeals Have At Least One Appeals Officer and Settlement Officer Located and Permanently Available within Every State, the District of Columbia, and Puerto Rico**

Problem

When passing RRA 98, Congress expressed the desire that all taxpayers should enjoy convenient access to Appeals, regardless of their locality. Specifically, in § 3465(b) of RRA 98, Congress required the IRS to ensure that an Appeals Officer is regularly available within each state. The IRS does not appear to have responded directly to this mandate, continuing instead to rely on circuit riding as a means of providing Appeals Officers and Settlement Officers to states lacking a permanent Appeals presence. Almost one quarter of the states (12 out of 50) now have no permanent Appeals presence, and circuit riding Appeals cases often take an additional 6 months or more to resolve than face-to-face Appeals cases conducted in permanent field offices. The IRS's contention that convenient access to Appeals can be adequately satisfied through its system of circuit riding is not supported by the available evidence. *The right to appeal an IRS decision in an independent forum, the right to quality service, the right to challenge the IRS's position and be heard, and the right to a fair and just tax system*, which are all part of the Taxpayer Bill of Rights, are violated when a face-to-face Appeals conference is not readily and conveniently available with an Appeals Officer or Settlement Officer possessing local background and information.

Analysis

Taxpayers who choose, or are compelled by circumstance, to accept a circuit riding conference are often negatively impacted. Available data indicates that appeals with face-to-face conferences held via circuit riding have significantly lower agreement rates, have substantially higher levels of disagreement, and are more likely to yield dissatisfied taxpayers than appeals with face-to-face conferences held in permanent field offices. These adverse impacts of circuit riding, which is the IRS's current means of serving states lacking a permanent Appeals presence, cause taxpayers to question the fairness and independence of the Appeals process, and result in negative downstream consequences for the IRS, such as additional litigation.

Recommendations

The National Taxpayer Advocate recommends that Congress pass legislation requiring that Appeals have at least one Appeals Officer and Settlement Officer located and permanently available within every state, the District of Columbia, and Puerto Rico.

LR #3 **RETURN PREPARATION: Require the IRS to Provide Return Preparation to Taxpayers in Taxpayer Assistance Centers and Via Virtual Service Delivery**

Problem

Beginning in the 2014 tax filing season, the IRS eliminated return preparation services by employees at Taxpayer Assistance Centers (TACs). Instead, the IRS directed, low income, disabled, and elderly taxpayers to Free File software or Volunteer Income Tax Assistance and Tax Counseling for the Elderly (VITA/TCE) sites. Regardless of their income level or situation, taxpayers can no longer have IRS employees prepare their returns, even though employee-prepared returns were more accurate than those from other sources. The remaining avenues for free preparation, such as VITA and TCE, are limited in the types and scope of returns they can handle. Inexplicably, the IRS funded VITA grantees by one hundred thousand dollars less than FY 2013 levels and diverted resources to the TCE grant program, despite the fact that TCE prepared a quarter of a million fewer returns in FY 2014 than in FY 2013. Because every federal grant dollar must be matched by the VITA grantee, a requirement that is not imposed on TCE grantees, the IRS funding decisions reduced resources available to the VITA grant program by \$200,000 in FY 2014, despite an increased number of returns prepared by the program.

Analysis

By ending free return preparation, the IRS has made it more difficult for taxpayers to find this important service. This may cause taxpayers to not file at all, which decreases filing compliance. Alternatively, taxpayers may seek assistance from paid preparers that imposes new burdens, including transportation costs and preparers' fees, on predominantly low income, elderly, and disabled taxpayers the TACs previously served. Some low income taxpayers who are unable to file will lose credits and deductions they would be otherwise eligible for, such as the Earned Income Tax Credit and Child Tax Credit. Vulnerable taxpayers may turn either to volunteer sites that may not prepare the type of returns the taxpayers need, or to paid preparers, forcing the taxpayers to pay for an essential service the government previously provided for free. Failing to offer return preparation by IRS employees undermines *the right to quality service* articulated in the recently adopted Taxpayer Bill of Rights.

Recommendations

The National Taxpayer Advocate recommends that Congress require the IRS to provide return preparation for low income, disabled, and elderly taxpayers in TACs and by virtual service delivery; and provide sufficient funding for IRS personnel to offer return preparation in TACs.

LR #4 **VIRTUAL SERVICE DELIVERY (VSD): Establish Targets and Deadlines for the Development and Implementation of VSD in Brick & Mortar Locations, in Mobile Tax Assistance Units, and Over the Internet**

Problem

As an element of the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress recognized that videoconferencing and similar technologies present opportunities for effective tax administration. Virtual service delivery (VSD) is an indispensable means of facilitating important taxpayer rights such as the *right to quality service*, the *right to challenge the IRS's position and be heard*, and the *right to a fair and just tax system*. Without access to VSD, taxpayers in remote areas have limited options for obtaining face-to-face interactions with IRS employees, which can be especially important in communicating complex matters, raising objections, providing documentation, and assessing credibility. More than ever, taxpayers and the IRS would benefit from the cost savings and improved customer service produced by VSD. Despite these benefits and some initial steps to implement this technology, the IRS has not developed a comprehensive approach to VSD in brick and mortar locations, in mobile tax assistance units, or over the Internet.

Analysis

Notwithstanding the insights of the IRS Restructuring Commission, the directives of RRA 98, and the successes of other agencies, the IRS is still operating as a 20th century business, primarily relying on postal correspondence, telephone conversations, and taxpayer visits to brick and mortar locations. Although taxpayers and their representatives would embrace VSD, the IRS, due to security, personnel, and funding challenges, has generally not moved beyond the piloting phase of VSD. Expanding access to VSD either in public buildings or in mobile tax assistance units is particularly essential for taxpayers who do not have, or are not proficient with, home computers. Moreover, the IRS's taxpayer digital communications (TDC) effort, which would allow a wide range of interactions with the IRS over the Internet, remains in its conceptual stages and should be accelerated. As with the 80 percent electronic filing goal, which was also part of RRA 98 and has now been achieved, congressional intervention and oversight with respect to development targets, deadlines, and budgets, would enhance and expedite the IRS's VSD initiatives.

Recommendations

The National Taxpayer Advocate recommends that Congress pass legislation to: establish targets and timelines for development and implementation of VSD in brick and mortar locations, including non-IRS facilities, in mobile tax assistance units, and via TDC over the Internet; and provide funding, or require the IRS to allocate funding, sufficient to enable continued implementation of VSD initiatives in brick and mortar locations, in mobile tax assistance units, and over the Internet.

THE RIGHT TO A FAIR AND JUST TAX SYSTEM: COMPLEXITY

LR #5 **SECTION 501(c)4) POLITICAL CAMPAIGN ACTIVITY: Enact an Optional “Safe Harbor” Election that Would Allow IRC § 501(c)4) Organizations to Ensure they Do Not Engage in Excessive Political Campaign Activity**

Problem

Organizations exempt from tax as IRC § 501(c)4) organizations may engage in political campaign activity, but only if they are “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community.” Promoting social welfare does not include participation or intervention in political campaigns. There is no statutory or regulatory quantification of the term “*primarily*” for this purpose, nor is there a statutory or regulatory “safe harbor” for determining whether an IRC § 501(c)4) organization’s political campaign activities fall within permissible limits. The IRS uses a facts-and-circumstances test to determine if an organization has engaged in political campaign activity to an impermissible extent. IRS procedures allow some organizations to attest that they devote 60 percent or more of both their spending and time (including volunteer time) to activities that promote social welfare. However, these procedures disproportionately exclude organizations from exempt status when they actually spend a *smaller* portion of their expenditures on political campaign activity.

Analysis

According to the Taxpayer Bill of Rights, taxpayers have the *right to be informed, i.e.*, “the right to know what they need to do to comply with the tax laws.” A provision analogous to the elective safe harbor under IRC § 501(h), which establishes an acceptable level of expenditures on lobbying activities by electing IRC § 501(c)3) organizations, would establish an acceptable level of expenditures on political campaign activity for electing IRC § 501(c)4) organizations, taking into account the organization’s size and budget. Volunteer time and activity, which do not generate taxable income for which tax exemption would be available in the first instance, would be irrelevant (except to the extent an expenditure arises as a consequence of volunteer activity).

Recommendation

Enact an optional “safe harbor” election similar to IRC § 501(h) that would allow IRC § 501(c)4) organizations to elect the use of a numerical test, based solely on their expenditures (*i.e.*, without counting volunteer activities), to determine the amount of political campaign activity they may engage in without jeopardizing their exempt status.

LR #6 FOREIGN ACCOUNT REPORTING: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure

A U.S. citizen or resident with foreign accounts exceeding \$10,000 can be subject to disproportionate civil penalties for failure to report the accounts on a *Report of Foreign Bank and Financial Accounts* (or FBAR) by June 30 of the following year. Another penalty may apply if the accounts exceed \$50,000 and the person does not report them on Form 8938, *Statement of Specified Foreign Financial Assets*, which is part of the tax return.

Although the FBAR penalty was aimed at bad actors, benign actors (*i.e.*, those who inadvertently failed to file an FBAR) are afraid they could be penalized for *willful* FBAR violations because the government may rely on circumstantial evidence of willfulness. These fears have prompted some to enter the IRS's offshore voluntary disclosure (OVD) settlement programs and pay severe penalties. The median penalty applied to taxpayers with the smallest accounts (*i.e.*, those in the 10th percentile with accounts of \$17,368 or less) under the 2011 OVD program, is more than eight times the unreported tax.

The IRS reduced the amount benign actors had to pay under a 2014 streamlined program (and allowed those with open OVD cases to receive the same terms), but did not allow those who had already signed closing agreements to receive the same terms. As a result, some people feel penalized for correcting the problem earlier.

Unexpected and disproportionate FBAR penalties may violate a taxpayer's rights *to be informed and to a fair and just tax system*. Because they prompted benign actors to pay excessive OVD settlements, they may also erode the rights to *pay no more than the correct amount of tax, challenge the IRS's position and be heard, and appeal an IRS decision in an independent forum*.

In the legislative recommendations that follow, the National Taxpayer Advocate offers specific proposals to:

- Improve the proportionality of the civil FBAR penalty;
- Require the government to prove actual willfulness before imposing the penalty for willful violations;
- Treat taxpayers who correct violations early the same as (or better than) those who correct them later; and
- Reduce the burden of foreign account reporting.

These proposals should help address concerns about the existing offshore penalty programs, and also establish principles of procedural fairness that could help the government design future penalty initiatives.

PENALTIES: Improve the Proportionality of the Civil FBAR Penalty

Problem

The maximum civil FBAR penalty for nonwillful violations is disproportionate—\$10,000 per account per year for up to six years. It rises to 50 percent of the maximum account balance (or, if greater, to \$100,000) for willful violations. For example, someone with a total of \$10,000 in five different foreign accounts (\$2,000 in each) could be subject to a non-willful FBAR penalty of \$300,000 (six years times five accounts times \$10,000) or 30 times the account balance. If the IRS deems the violation willful, the penalty could rise to \$3 million (six years times five accounts times \$100,000) or 300 times the account balance. The IRS has mitigation guidelines for applying smaller penalties in limited situations because the statutory maximums may “greatly exceed an amount that would be appropriate in view of the violation,” according to the Internal Revenue Manual. However, these guidelines do not apply to everyone.

Analysis

Legislative history suggests that even the nonwillful civil FBAR penalty was aimed at bad actors engaged in criminal activity. Yet it can hit benign actors who inadvertently failed to file an FBAR even if they have little or no underpayment and the unreported account(s) were not used for criminal activity. It may even apply to the failure to report a checking or savings account in the jurisdiction where the taxpayer resides. FBAR penalties can also overlap with penalties for failure to report the same account(s) on Form 8938, *Statement of Specified Foreign Financial Assets*, and with the 40 percent penalty for understatements attributable to undisclosed foreign financial assets. By contrast, there is no penalty for failing to file a U.S. income tax return if there is no unpaid tax, and the penalty for failure to file most other information returns is generally \$100 per return, rising to ten percent of the unreported amount for intentional violations.

Recommendations

The National Taxpayer Advocate recommends capping the civil FBAR penalty at the lesser of: (1) ten percent of the unreported account balance or five percent for non-willful violations (similar to the IRS’s mitigation guidelines), and (2) 40 percent of the portion of any underpayment attributable to the improperly undisclosed accounts (similar to the penalty for undisclosed foreign financial assets). She also recommends waiving the penalty when the account information was already provided to the IRS by a third party or on another form; when the unreported income from the account does not create a substantial understatement; and when the taxpayer resides in the same jurisdiction as the account, provided there is no evidence the account was used in a crime.

PENALTIES: Require the Government to Prove Actual Willfulness Before Imposing the Penalty for Willful FBAR Violations

Problem

Benign actors cannot be sure the IRS will not view their FBAR violations as “willful,” and attempt to impose severe penalties. This is because the government has eroded the distinction between willful and non-willful violations. As a result, some benign actors agree to pay more under the IRS’s OVD settlement programs than they would after an examination.

Analysis

The IRS may meet its burden of proving willfulness if it shows a violation is a “voluntary, intentional violation of a known legal duty.” Because Schedule B of Form 1040, *U.S. Individual Income Tax Return*,

asks if the taxpayer has a foreign account and references the FBAR filing requirement, however, the government has been successful in arguing—in cases involving bad actors—that filing a Schedule B can turn a subsequent failure to file an FBAR into a willful violation (called “willful blindness”), at least if combined with other factors such as efforts to conceal the account. It is unclear what other factors the IRS will consider. It is also unclear if the IRS will distinguish between efforts to conceal the accounts with the intent to evade U.S. taxes or conceal crimes, as opposed to inadvertent concealment, or concealment based on concerns about financial privacy or fears of unwarranted persecution, seizure, or extortion by a government or others (*e.g.*, terrorists or organized criminals). Given this uncertainty, as well as the time and cost of representation in an examination and any potential administrative and appeals, some benign actors have agreed to pay more under the IRS’s OVD settlement program than they would after an examination. Legislation to clarify that the IRS may only assert a willful FBAR penalty if it can prove the violation was actually willful would reduce the IRS’s excessive discretion in determining what penalty may apply. It would also support the taxpayer *right to be informed*, which includes the right to a clear explanation of the law.

Recommendation

The National Taxpayer Advocate recommends legislation to clarify that the government has the burden to establish actual willfulness (*i.e.*, specific intent to violate a known legal duty) before asserting a willful FBAR penalty, and cannot meet this burden by relying solely on circumstantial evidence.

CLOSING AGREEMENTS: Authorize the IRS to Modify Closing Agreements to Treat Taxpayer Who Correct Violations Early the Same As (or Better Than) Those Who Correct Them Later

Problem

The IRS announced changes to its Offshore Voluntary Disclosure (OVD) programs in 2014. These changes generally allowed benign actors (*i.e.*, those who certified their violations were not willful) to pay less to correct FBAR reporting violations. In contrast to prior revisions to its OVD programs, however, the IRS did not allow those with signed closing agreements to benefit from the more lenient program terms announced in 2014.

Analysis

The IRS may not have the legal authority to modify OVD closing agreements. Under common law principles, agreements can be modified with the consent of both parties. Moreover, Treasury Regulation § 301.7121-1(b)(1) contemplates “a series of closing agreements relating to the tax liability for a single period,” which might suggest, in effect, a change to the original agreement. However, IRC § 7121(b) provides that with limited exception, closing agreements “shall be final and . . . shall not be reopened as to the matters agreed upon or the agreement modified.” Thus, legislation to clarify that the parties can modify closing agreements by consent would empower the IRS to treat those who corrected violations early the same as those who corrected them later.

Recommendations

The National Taxpayer Advocate recommends legislation to authorize the IRS to modify closing agreements with the taxpayer’s consent, particularly when necessary to promote equity or public policy (including consistency). She further recommends directing the IRS to use this authority to amend OVD closing agreements to make them consistent with the terms of agreements publicly offered to similarly-situated taxpayers in subsequent IRS programs.

FBAR FORMS: Reduce the Burden of Foreign Account Reporting

Problem

U.S. citizens and residents may be required to report foreign accounts on different forms (FBAR vs. Form 8938), at different times of the year (June 30 for FBAR vs. April 15th or September 15th for Form 8938), when they reach different thresholds (\$10,000 for FBAR vs. \$50,000 or more for Form 8938), and using different definitions, even though the government may already know about the accounts. Because of the Foreign Account Tax Compliance Act (FATCA), in 2015 many banks will also begin reporting the foreign accounts of U.S. persons to the IRS. All of these requirements combine to make foreign account reporting excessively burdensome.

Analysis

Requiring taxpayers to report many of the same accounts on two different forms on two different dates may increase preparation expenses and the possibility of error. Taxpayers must remember two filing deadlines and potentially pay to consult two different advisors at two different times. In addition, although the \$10,000 FBAR reporting threshold has fluctuated, it is the same as it was in 1970. If indexed for inflation from 1970, it would be more than \$61,000 in today's dollars – significantly more than the \$50,000 threshold the IRS established for reporting on Form 8938. Over 30 percent of the FBARs the IRS received in calendar year 2012 reported accounts of less than \$49,999. Thus, assuming most taxpayers file only one form, coordinating the FBAR filing threshold with the Form 8938 threshold could reduce taxpayer burden by nearly one third. Moreover, information about larger accounts may be more useful for tax administration. One reason the IRS cannot create a new form that consolidates foreign account reporting is because taxpayer privacy protections prohibit the IRS from sharing information from a tax return (*e.g.*, from Form 8938) with the Financial Crimes Enforcement Network (FinCEN), which needs the information provided on an FBAR.

Recommendations

The National Taxpayer Advocate recommends legislation to align the FBAR filing deadline and threshold(s) with the Form 8938 filing deadline and threshold(s). She further recommends requiring the Treasury Department to consolidate the reporting of foreign accounts (*i.e.*, the FBAR and Form 8938) so taxpayers only have to report them on one form. To facilitate this change, the legislation could authorize the IRS to disclose the information now reported on an FBAR to FinCEN without violating the privacy rules applicable to tax information, as long as the information is prominently identified on the new form as either not being part of the return or not subject to the privacy rules.

LR #7 **FILING STATUS: Clarify the Definition of “Separate Return” in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Status to Married Filing Jointly in Accordance with Tax Court Rules of Practice and Procedure**

Problem

Internal Revenue Code (IRC) § 6013 precludes a married taxpayer who has filed a “separate return,” an undefined term, from filing an amended return electing Married Filing Jointly (MFJ) status for the same tax year once either spouse has filed a Tax Court petition in response to a statutory notice of deficiency (SNOD). The courts disagree about the interpretation of “separate return.” Thus, whether a taxpayer may change his or her filing status to MFJ depends on the location of the Court of Appeals that would hear an appeal of a Tax Court decision. In addition, taxpayers who are unaware that the IRC allows for changes in filing status, and to whom limitations apply, may pay taxes at a higher effective rate and experience financial hardship. Taxpayer rights, including the *right to be informed*, the *right to pay only the amount of tax legally due*, and the *right to fair and just tax system* are negatively affected.

Analysis

Married taxpayers who filed returns with a status of Married Filing Separately (MFS), single, or head of household are allowed to change their status to MFJ subject to certain limitations of IRC § 6013. Married taxpayers who do not initially file a joint return may change to MFJ as long as: one of the spouses filed a “separate return,” which is not defined in the statute or applicable regulations; the couple was eligible to file a joint return for the tax year in which the “separate return” was filed; the time limit for filing a joint return has not expired; and neither spouse has filed a Tax Court petition in response to a statutory notice of deficiency. The courts have reached different conclusions about the meaning of IRC § 6013(b). In *Glaze v. United States*, the Court of Appeals for the Fifth Circuit held that the term “separate return” means only a return filed as MFS. This precedent is also followed in the Eleventh Circuit. The Tax Court, however, interprets “separate return” to mean any filing status other than MFJ and does not follow the *Glaze* decision except in cases where an appeal would lie in the Fifth or Eleventh Circuits based on the *Golsen* rule. The Court of Appeals for the Eighth Circuit is considering the same issue on appeal in *Ibrahim v. Commissioner*.

Recommendations

The National Taxpayer Advocate recommends that Congress amend IRC § 6013(b)(1) by clarifying that the term “separate returns” means any return that is not a joint return; and amend IRC § 6013(b)(2)(B) to give taxpayers the right to change their filing status to MFJ after filing a Tax Court petition in response to a SNOD, in accordance with rules of practice and procedure of the Tax Court or, in the alternative, eliminate IRC § 6013(b)(2)(B).

LR #8 ERRONEOUS REFUND PENALTY: Amend Section 6676 to Permit “Reasonable Cause” Relief**Problem**

A taxpayer who claims a tax credit or refund that the IRS disallows may be liable for a penalty under Internal Revenue Code (IRC) § 6676 unless the taxpayer had a “reasonable basis” for the claim. Section 6676 does not appear to require the IRS to take into account all the facts and circumstances, including the taxpayer’s knowledge and experience with tax law and his or her efforts to comply with the law, in determining whether there was such reasonable basis. Taxpayers may satisfy the reasonable basis standard if they have “substantial authority” for their return position, but substantial authority does not include IRS forms or accompanying instructions, IRS publications, or IRS answers to Frequently Asked Questions—materials that many individual taxpayers rely on for guidance. While the section 6676 penalty does not apply to erroneous claims for Earned Income Tax Credit (EITC), it may apply to disallowed claims for other social benefits, such as the additional child tax credit and the new Premium Tax Credit under the Affordable Care Act (ACA). The rules for claiming these income-based refundable credits, available to low income taxpayers who face unique obstacles in understanding and substantiating eligibility, are complex and varied, which raises the likelihood of mistakes. Other tax penalties, including the civil fraud penalty, contain an exception for “reasonable cause.” Determining whether there was “reasonable cause” for a claim requires consideration of all the taxpayer’s facts and circumstances.

Analysis

According to the Taxpayer Bill of Rights, taxpayers have the *right to a fair and just tax system*—“the right to expect the tax system to consider facts and circumstances that might affect their underlying liabilities....” Providing for a reasonable cause exception to the section 6676 penalty would bring this statutory penalty into conformity with the TBOR right to a fair and just tax system. It would take into account recent judicial interpretations of sections 6662 and 6676, would be consistent with the accuracy-related penalty provisions of section 6662, would avoid subjecting unsophisticated taxpayers to a penalty intended to reach taxpayers who take calculated risks in their reporting positions, and would permit consistent treatment of similarly situated taxpayers.

Recommendation

Amend IRC § 6676 to permit relief from the penalty for erroneously claiming a credit or refund for individual taxpayers who acted with reasonable cause and in good faith.

THE RIGHT TO BE INFORMED: ACCESS TO THE IRS

LR #9 **ACCESS TO THE IRS: Require the IRS to Publish a Public Phone Directory and Report on Implementing an Operator System Similar to “311” Lines**

Problem

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to publish the phone number and address of each local office in local phone books across the country. Even if the IRS meets this requirement by effectively publishing the numbers for local offices in phone books, the IRS is not achieving the purpose of the provision—to make itself accessible to taxpayers. Taxpayers do not know how to reach a specific department within the IRS, if they can even identify which department they need to talk to. Those who call the IRS often must navigate an extended phone tree before being transferred, and are sometimes transferred to a recorded message and never given a chance to speak to a live person. When taxpayers cannot find the right employee or manager to talk to about their issues, or cannot speak to an employee at all, their *right to quality service* is compromised.

Analysis

Since 1998, much has changed about the way the IRS is organized and about how people find other people and businesses. Congress may not have anticipated how few services local IRS offices would come to provide for taxpayers, or how heavily taxpayers would rely on written or phone communication with offices scattered around the country. Although the IRS publishes the numbers for its local offices in phone books, this is of little help because those offices do not answer taxpayers' calls or allow them to leave messages. Furthermore, taxpayers often need to reach a specific department within a local office, such as the local Examination or Appeals office, and these numbers are not published. Although RRA 98 requires the IRS to provide the option to speak to a live person on helplines, taxpayers do not have this option when they call the main toll-free line. The IRS's procedure for answering, screening, and working phone calls makes it difficult for some taxpayers to speak to an employee within the office handling the their issue.

Recommendations

The National Taxpayer Advocate recommends that Congress enact legislation to require the IRS, within 180 days, to publish on IRS.gov, its current Practitioner Directory or a similar directory that provides the names and contact information for managers of local IRS groups or territories for different functions of the IRS, as well as managers of service and compliance functions in IRS campuses; and develop a report detailing the administrative steps necessary to implement an operator system for its main toll-free phone line, similar to a 311 line. Under such a system, all taxpayers would call a single nationwide toll-free number and answer a limited number of questions through an interactive voice response system before being transferred to an operator. If a taxpayer needs a specific piece of information such as an account balance or transcript, the operator would provide the information to the taxpayer. The operator would transfer calls regarding other IRS functions and offices to the specific office handling the taxpayer's individual issue or case. The IRS would provide the report to the Senate Committee on Finance and the House Committee on Ways and Means.

LR #10 IRS CORRESPONDENCE: Codify § 3705(a)(1) of RRA 98, Define “Manually Generated,” and Require Contact Information on Certain Notices in All Cases**Problem**

Concerned about taxpayers’ access to IRS employees who are both knowledgeable about and accountable for actions taken on their cases, Congress required the IRS in the IRS Restructuring and Reform Act of 1998 (RRA 98) to include employee contact information on “manually generated correspondence.” The IRS has failed to meaningfully implement the requirements of § 3705(a)(1) of RRA 98. While the IRS defined the term “manually generated” in the IRM, it does not follow its own manual and fails to include appropriate employee contact information on most computer-generated notices, even when a particular employee has worked on the case or exercised judgment and made a decision. IRS correspondence procedures fail to address Congress’s concerns about the inability of taxpayers to contact an IRS employee who is knowledgeable about and accountable for the case.

Analysis

Left to define “manually generated” on its own, the IRS does not report either seeking an official Chief Counsel opinion on the meaning of the term nor performing a comprehensive review of notices that should include contact information to address Congress’ concerns about employee access and accountability. While it may be unnecessary or impractical to include contact information for a specific employee on all notices, particularly before a case is assigned, failing to do so after a taxpayer has communicated with the IRS may violate the law and contradict the IRS’s own Internal Revenue Manual. The codification of RRA 98 § 3705 with a specific definition of manually generated notices and specific requirements about when the contact information must be included will ensure the IRS’s accountability and provide real meaning to the taxpayer *rights to quality service, to be informed, and to a fair and just tax system.*

Recommendations

The National Taxpayer Advocate recommends that Congress codify RRA 98 § 3705(a)(1); define the term “manually generated correspondence” as correspondence issued as a result of an IRS employee exercising his or her judgment in working or resolving a specific taxpayer case or correspondence, or where the employee is asking the taxpayer to provide additional case-related information; and require the IRS to provide the name, telephone number, and unique identification number of an IRS manager on notices with legal impact, such as those that start the running of a statute of limitations or trigger appeal rights (such as the Statutory Notice of Deficiency), where such notices have been automatically generated without employee review.

THE RIGHT TO BE INFORMED: ADEQUATE EXPLANATION

LR #11 ANNUAL NOTICES: Require the IRS to Provide More Detailed Information on Certain Annual Notices it Sends to Taxpayers

Problem

The IRS is required by law to send an annual statement to taxpayers who have an installment agreement in effect and to provide an annual reminder notice to taxpayers with delinquent accounts. However, these statements and notices fail to provide a detailed breakdown of accrued interest and penalties (and the type of penalty), and how payments (including refund offsets) are applied to tax, penalties, and interest. This lack of information prevents taxpayers from having a complete and accurate picture of their tax accounts and making informed economic decisions about their debts. Taxpayers also cannot determine that their payments have been applied properly and that they are paying no more than the amount of tax legally due. This undermines taxpayers' *rights to be informed* and *to pay no more than the correct amount of tax*.

Analysis

Section 3506 of the Internal Revenue Service Restructuring and Reform Act of 1998 requires the IRS to send annual statements to taxpayers who have an installment agreement in effect under Internal Revenue Code (IRC) § 6159. This statement must provide a taxpayer's initial balance at the beginning of the year, payments made during the year, and the remaining balance as of the end of the year. However, the IRS is not currently required to and does not provide a detailed breakdown of accrued interest and penalties (and the type of penalty), or how payments (including refund offsets) are applied to tax, penalties, and interest. Section 1204 of the Taxpayer Bill of Rights 2 added § 7524 to the IRC, which requires the IRS to send to taxpayers with delinquent accounts an annual reminder notice that sets forth the amount of the delinquency as of the date of the notice. Again, however, the IRS is not required to and does not provide a detailed breakdown on the notice showing the balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), and how payments (including refund offsets) are applied to tax, penalties, or interest.

Recommendation

The National Taxpayer Advocate recommends that Congress require the IRS to provide on certain annual statements and notices, within one year of the enactment date, a detailed breakdown of information showing the last balance due at the beginning of the year, additions to this amount attributable to interest and penalties (and the type of penalty), both cumulatively and for the last 12 months, and how payments (including refund offsets) received since the beginning of the year are applied to tax, penalty, and interest.

THE RIGHTS TO APPEAL AND TO CHALLENGE THE IRS'S POSITION AND BE HEARD

LR #12 **EO JUDICIAL AND ADMINISTRATIVE REVIEW: Allow IRC § 501(C)(4), (C)(5), or (C)(6) Organizations to Seek a Declaratory Judgment to Resolve Disputes About Exempt Status and Require the IRS to Provide Administrative Review of Automatic Revocations of Exempt Status**

Problem

In contrast to Internal Revenue Code (IRC) § 501(c)(3) organizations, IRC § 501(c)(4), (5), or (6) organizations are not entitled to a declaratory judgment by a court as to their exempt status if their applications are denied, if the IRS fails to make a determination on their applications after 270 days, or if their exempt status is revoked. Consequently, there is comparatively little judicial guidance about the requirements for exempt status under IRC § 501(c)(4), (c)(5), and (c)(6), less IRS accountability for delays in processing applications for exempt status under those subsections, and no venue where affected organizations can directly challenge an IRS determination. Organizations whose exempt status is automatically revoked for failing to file required returns or notices for three consecutive years also cannot obtain judicial review. Because the IRS does not allow administrative review of automatic revocations, these organizations may have no venue in which to demonstrate they were erroneously treated as no longer exempt.

Analysis

Congress enacted IRC § 7428, which allows section 501(c)(3) organizations to seek a declaratory judgment as to their exempt status, because Congress was concerned that the absence of judicial review of IRC § 501(c)(3) determinations left organizations subject to undue delay, conferred too much power on the IRS, and impeded interpretive case law. This risk exists today for other IRC § 501(c) organizations. Allowing IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek such review will provide better guidance to taxpayers and to the IRS, thereby protecting taxpayers' *right to be informed, i.e., "the right to know what they need to do to comply with the tax laws"* and their *right to appeal an IRS decision in an independent forum*. The IRS has erroneously treated thousands of organizations as having had their exempt status automatically revoked and has adopted computer programming that will cause additional erroneous revocations. Requiring a procedure for administratively reviewing those revocations would protect taxpayers' *right to appeal an IRS decision in an independent forum*.

Recommendations

The National Taxpayer Advocate recommends that Congress amend IRC § 7428 to allow taxpayers seeking exempt status as IRC § 501(c)(4), (c)(5), or (c)(6) organizations to seek a declaratory judgment on the same footing as currently allowed for taxpayers seeking exempt status as § 501(c)(3) organizations; and amend IRC § 6033(j) to require the IRS to adopt administrative review procedures for organizations treated as having had their exempt status automatically revoked.

LR #13 STANDARD OF REVIEW: Amend IRC § 6330(d) to Provide for a De Novo Standard of Review of Whether the Collection Statute Expiration Date is Properly Calculated by the IRS**Problem**

Collection Due Process (CDP) hearings provide taxpayers with an independent review by the IRS Office of Appeals of the IRS's decision to file the initial Notice of Federal Tax Lien (NFTL) or proposal to undertake its first levy action with respect to a tax liability. At the hearing, the Appeals officer is required to "obtain verification from the Secretary that the requirements of any applicable law or administrative procedure have been met," including the correct calculation of the collection statute expiration date (CSED). In a series of decisions, the Tax Court has held that CSED issues can be both related and not related to the underlying liability. As a result, the Tax Court may only review some taxpayers' allegations of an expired CSED for abuse of discretion, a difficult standard for taxpayers to prove. The Tax Court's review under the abuse of discretion standard is limited to what is in the taxpayer's administrative file, which will include issues raised at the CDP hearing. However, taxpayers do not have easy access to information related to the calculation of their CSED, which the IRS holds. Taxpayers may not know how to raise CSED issues during the CDP hearing, and as a result will be precluded from raising these arguments or introducing new evidence during Tax Court proceedings. Finally, the IRS's CSED calculation is not always accurate. Because the limited review of CSED issues based on the abuse of discretion standard affects half of the rights afforded to taxpayers in the Taxpayer Bill of Rights, this recommendation to amend the Code will go a long way in protecting taxpayer rights.

Analysis

The Tax Court's review under the abuse of discretion standard is limited to what is in the taxpayer's administrative file, which will only include issues raised at the CDP hearing. This is different from the *de novo* standard of review, which allows the court to take a fresh look at the issue. The *de novo* standard now applies only when the taxpayer is challenging the underlying liability, which pursuant to IRC § 6330(c)(2)(B), can be done when the taxpayer has not previously received a statutory notice of deficiency or has meaningfully participated in another opportunity to dispute the liability. Legislative history does not address whether CSED issues under IRC § 6330(c)(1) relate to the taxpayer's underlying liability. The IRS Office of Chief Counsel recently issued guidance stating that verification of CSED calculations should receive abuse of discretion review, which is limited in its scope, based on the premise that CSED does not affect the underlying liability. A review of the CDP program by the Treasury Inspector General for Tax Administration in 2013 found approximately 21 percent of closed CDP cases reviewed had inaccurate CSED calculations because Appeals did not accurately input the CSED suspension code related to the CDP hearing. The incorrect calculation of the CSED has the potential to result in unlawful collection activity against taxpayers. The abuse of discretion standard is deferential to the government and requires the court to limit its review of CSED issues to the administrative record, regardless of its accuracy. A *de novo* review would ensure accurate CSED calculation and protect taxpayers from unlawful collection action.

Recommendation

The National Taxpayer Advocate recommends that Congress amend IRC § 6330(d) to provide for a *de novo* standard of review by the Tax Court of whether the CSED is properly calculated by the IRS pursuant to IRC § 6330(c)(1).

LR #14 **APPELLATE VENUE IN NON-LIABILITY CDP CASES: Amend IRC § 7482 to Provide That The Proper Venue to Seek Review of a Tax Court Decision in All Collection Due Process Cases Lies With the Federal Court of Appeals for the Circuit in Which the Taxpayer Resides**

Problem

Byers v. Commissioner recently considered the issue of proper appellate venue in Collection Due Process (CDP) cases that do not involve a redetermination of liability. The court concluded the proper venue for appealing U.S. Tax Court decisions in non-liability CDP cases lies with the Court of Appeals for the District of Columbia Circuit (D.C. Circuit) unless the case type falls under one of the rules specified in Internal Revenue Code (IRC) § 7482(b)(1) or (b)(3) or the parties both stipulate in writing. Prior to this decision, taxpayers, tax practitioners, and the government adhered to a general practice of appealing all Tax Court decisions involving IRC §§ 6320 and 6330 (CDP lien and levy actions) to the court of appeals for the circuit in which the taxpayer lived (regional court). The *Byers* decision creates uncertainty about the proper venue for appeals of non-liability CDP determinations from the Tax Court, and may result in some forum shopping by litigants who are aware of its implications. Also, if the regional circuit courts of appeal agree with *Byers*, such a holding would require all of these cases to be appealed to the D.C. Circuit. This would disproportionately burden low-income taxpayer who do not have the means to travel to the District of Columbia or the means to pay someone to travel to the District of Columbia. Finally, *Byers* did not provide any guidance as to what will happen when a non-liability CDP appeal is filed in a regional court without stipulation.

Analysis

The holding in *Byers* could mean that taxpayers who have similar procedural issues and reside in the same place could receive significantly different results if one taxpayer challenging the underlying liability obtains review by the regional court, and the other taxpayer not challenging underlying liability obtains review by the D.C. Circuit. The difference in results could lead to an increased perception that the tax system is unfair. The *Byers* holding could also lead to an increase in unwarranted challenges to a taxpayer's underlying liability and unnecessary litigation because the taxpayer wants to create a clear path to the regional circuit court. Absent congressional clarification, the confusion about proper venue may affect the taxpayer's *rights to be informed* and *to a fair and just tax system*. Ultimately, the *Byers* interpretation of § 7482(b)(1) may foster a system where represented taxpayers are better equipped to navigate the appeal process, negatively affecting *rights* for unrepresented taxpayers who constituted 63 percent of litigated CDP cases between June 1, 2013 and May 31, 2014.

Recommendation

The National Taxpayer Advocate recommends that Congress amend IRC § 7482(b)(1)(A) to provide that proper appellate venue for all CDP cases lies with the circuit court of appeals based on the taxpayer's legal residency.

THE RIGHTS TO PRIVACY AND TO A FAIR AND JUST TAX SYSTEM

LR #15 OFFERS IN COMPROMISE: Authorize the National Taxpayer Advocate to Determine Whether an Offer in Compromise Submitted by a Victim of Payroll Service Provider Fraud Is “Fair and Equitable”

Problem

Many small businesses outsource payroll and related tax duties to third-party payroll service providers (PSPs). If a PSP embezzles funds it should have paid to the IRS, the business owner remains responsible for unpaid tax, interest, and penalties. The IRS has the discretionary authority to accept taxpayers' offers to compromise their tax debts for less than the full amount owed if certain conditions are met. Under the guidelines for evaluating offers in compromise based on effective tax administration (ETA) and submitted by victims of PSPs, the IRS is to inquire whether the offer will (1) result in a financial gain for the taxpayer; and (2) be “generally perceived within the community as a fair and equitable solution.”

Analysis

The first part of this inquiry is unnecessary because, by definition, a victim of preparer fraud will never be financially advantaged by the fraud, because he or she has already paid the taxes once. Regarding the second part of this inquiry, the National Taxpayer Advocate, as the “voice of the taxpayer” inside the IRS, is the appropriate official to assess whether an offer would be perceived as fair and equitable. In two other provisions of the Internal Revenue Code, Congress has explicitly designated the National Taxpayer Advocate as the one to determine whether an action is in the best interest of the taxpayer. First, in the context of lien withdrawals, the IRS determines whether withdrawing the lien is in the best interest of the United States but the National Taxpayer Advocate decides whether it is in the *taxpayer's* best interest. A similar provision exists for releasing a levy; the National Taxpayer Advocate makes the determination of whether the return of property is in the taxpayer's best interest. Moreover, the Commissioner has acknowledged the National Taxpayer Advocate's role by delegating to her the authority to issue a Taxpayer Advocate Directive to protect the rights of groups of taxpayers (or all taxpayers), prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.

Recommendation

To address the inherent conflict with the IRS determining whether acceptance of an ETA offer in compromise submitted by a victim of payroll service provider fraud is fair and equitable, Congress should authorize the National Taxpayer Advocate to make such determinations.

LR #16 **MANAGERIAL APPROVAL FOR LIENS: Require Managerial Approval Prior To Filing a Notice of Federal Tax Lien in Certain Situations**

Problem

One of the IRS's most significant powers is its authority to file a Notice of Federal Tax Lien (NFTL) in the public records when a taxpayer owes past due taxes. The NFTL protects the government's interests in a taxpayer's property against subsequent purchasers, secured creditors, and junior lien holders. When properly applied, the IRS's lien authority can be an effective tool in tax collection but when used improperly, NFTLs can needlessly harm taxpayers and undermine long-term tax collection. In § 3421 of the IRS Restructuring and Reform Act of 1998 (RRA 98), Congress required the IRS to adopt procedures in which an employee's determination to file an NFTL would, "where appropriate," be approved by a supervisor, and to set out disciplinary actions when no such approval is obtained. However, the IRS has deemed it is rarely "appropriate" to require such approval. The IRS's decision to ignore Congress's directive and rely on a broad NFTL filing policy has had significant consequences for both the IRS and taxpayers and compromises a taxpayer's *rights to privacy* and *to a fair and just tax system*.

Analysis

Relying on the word "appropriate" in § 3421 of RRA 98, the IRS has made virtually no adjustments to its procedures along the lines of what Congress directed. In fact, the IRS has eased managerial approval requirements by granting lower-graded employees the authority to file NFTLs without managerial review. Flipping Congress's intent on its head, the IRS requires all employees to obtain managerial approval if they determine *not* to file an NFTL in certain cases. As illustrated by several significant Taxpayer Advocate Service (TAS) research studies, these expanded NFTL filing policies have not only been ineffective in collecting revenue, but impair payment compliance and the taxpayer's earnings. The filing of NFTLs rose by about 219 percent from fiscal year (FY) 1999 to 2014, yet the Collection function is collecting only slightly more real dollars than in 1999. These policies have particularly damaging effects on taxpayers whom the IRS has classified as "currently not collectible" because of economic hardship.

Recommendation

The National Taxpayer Advocate recommends that Congress codify § 3421 of RRA 98 to require IRS employees to obtain managerial approval prior to filing an NFTL where it is likely that the NFTL will cause a hardship, will do little to protect the government's interest in the taxpayer's property or rights to property, or will impair the taxpayer's ability to pay the tax; require the IRS supervisor, as part of the approval process, to consider whether the NFTL would attach to property, whether the benefit of filing an NFTL for the government would outweigh the harm to the taxpayer, and whether the NFTL filing will jeopardize the taxpayer's ability to comply with the tax laws in the future; and require the IRS to discipline employees who fail to secure managerial approval prior to filing an NFTL in situations required by law.

LR #17 **MANAGERIAL APPROVAL: Amend IRC § 6751(b) to Require IRS Employees to Seek Managerial Approval Before Assessing the Accuracy Related Penalty Attributable to Negligence under IRC § 6662(b)(1)**

Problem

Generally, Internal Revenue Code (IRC) § 6751(b)(1) provides that accuracy-related penalties must receive managerial approval prior to assessment. Yet penalties that are “automatically calculated through electronic means” do not require managerial approval. This exception makes sense in the context of the failure to pay and failure to file penalties, which require a relatively straightforward mathematical calculation and involve no exercise of judgment and discretion. However, the exception poses a problem, particularly for accuracy-related penalties imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations, because automatic assessments do not allow for consideration of the taxpayer’s particular facts and circumstances. Under the automatic assessment regime, a taxpayer who did make a reasonable attempt to comply and acted in good faith must take extra, burdensome steps to rid him or herself of an arbitrary penalty assessment. Not only does this approach undermine voluntary compliance, but it affects a taxpayer’s *right to quality service, right to pay no more than the correct amount of tax, and right to a fair and just tax system.*

Analysis

In the Automated Underreporter (AUR) program, when IRS computers detect a discrepancy on a taxpayer’s return, the IRS will issue an initial letter to the taxpayer, asking for an explanation. If the taxpayer does not respond, the IRS will issue a statutory notice of deficiency, proposing assessment of a liability and penalty, if the discrepancy occurred for a second year. If a taxpayer responds to either the initial letter or the notice of deficiency, the proposed penalty assessment will receive managerial approval. Taxpayers who do not respond will not receive managerial review of their penalty assessments. There are several reasons why a taxpayer may not reply to a notice. First, the taxpayer may not respond to the first notice because he or she agrees with the proposed liability and thus would not review the second notice that contains the penalty assessment. Second, low income taxpayers often face particular challenges in dealing with the IRS. Third, in an environment of continuing budget cuts, the inability to contact the IRS is a challenge for many taxpayers. Any one of these conditions will allow the IRS to impose a potentially incorrect penalty on a taxpayer’s account.

Recommendation

The National Taxpayer Advocate recommends that Congress amend IRC § 6751(b)(2)(B) to require written managerial approval prior to assessment of the accuracy-related penalty imposed on the portion of underpayment attributable to negligence or disregard of rules or regulations under IRC § 6662(b)(1).

LR #18 CONTACT INFORMATION ON STATUTORY NOTICES OF DEFICIENCY: Revise IRC § 6212 to Require the IRS to Place Taxpayer Advocate Service Contact Information on the Face of the Statutory Notice of Deficiency and Include Low Income Taxpayer Clinic Information with Notices Impacting that Population

Problem

Section 1102(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) provides that statutory notices of deficiency (SNODs) “shall include a notice to the taxpayer of the taxpayer’s right to contact a local office of the taxpayer advocate and the location and phone number of the appropriate office.” In addition, the Conference Report also provided further clarification by stating that the IRS should publish the right to contact the local office of the Taxpayer Advocate Service “on” the SNOD, as opposed to “with” the notice. A TAS review of the current inventory of SNODs found that the majority do not include the local contact information on the face of the notices and, in several instances, the TAS office local to the IRS office issuing the SNOD is listed instead of the office most likely to be local to the taxpayer receiving the SNOD. While the SNODs in question are still valid with the language required by IRC § 6212(a), the failure of the IRS to comply with the RRA 98 requirements harms taxpayers.

Analysis

The taxpayer’s receipt of a SNOD is a critical point in the audit or appeals process. The taxpayer needs information about what he or she must do to protect the right to an independent review of the proposed deficiency prior to assessment. The SNOD is a pre-assessment document, which means the taxpayer may still be able to resolve the issue before going to the United States Tax Court. To ensure the IRS adequately informs taxpayers of their right to contact TAS at a critical point in the tax controversy, the National Taxpayer Advocate believes that the IRS should place TAS contact information on the face of the SNOD rather than include such information as an insert. In addition, while TAS employees can explain to the taxpayer the right to file a petition in the Tax Court, Low Income Taxpayer Clinic (LITC) practitioners can assist an eligible taxpayer throughout the tax controversy and represent the taxpayer in court. Therefore, for those SNODs that are likely to impact the low income taxpayer population, the IRS should also provide LITC contact information on the face of the SNOD.

Recommendations

To adequately inform taxpayers of their right to seek assistance from TAS and an LITC, the National Taxpayer Advocate recommends that Congress revise IRC § 6212 to require the IRS to include local TAS contact information on the face of the SNOD. For those SNODs determined to likely impact the low income taxpayer population, the IRS should include a description and web link to LITC contact information on the face of the SNOD. If a SNOD has a deficiency that by definition impacts this population (such as the Earned Income Tax Credit), the IRS should also include a document that lists the contact information for all LITCs as an insert in the SNOD envelope.

LR #19 **LATE-FILED RETURNS: Clarify the Bankruptcy Law Relating to Obtaining a Discharge****Problem**

Taxpayers who face financial hardship and seek a bankruptcy discharge of their tax liabilities face uncertainty as to whether they will be able to obtain a discharge of these liabilities if they do not file their tax returns timely. This lack of clarity is due to conflicting judicial interpretations of a provision of § 523(a) of the Bankruptcy Code, which sets forth exceptions to bankruptcy discharge. As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Congress amended § 523(a) and added a paragraph at the end of this section, sometimes referred to as the “Hanging Paragraph,” which includes language providing “the term ‘return’ means a return that satisfies the requirements of applicable non-bankruptcy law (including applicable filing requirements).” Courts are split over this language. Some, including one circuit court of appeals, have held that a return must be filed timely in order to obtain a discharge. This means a taxpayer who otherwise meets the requirements but files an untimely return—even one day late—may be ineligible for a bankruptcy discharge. This rule can apply even where the IRS has determined the late filing was due to reasonable cause or a natural disaster, or because the taxpayer was in combat status. Other courts, and the IRS, do not interpret the “applicable filing requirements” language as requiring a timely filed return.

Analysis

This split in legal interpretation causes uncertainty for taxpayers seeking to discharge tax liabilities. Although the IRS currently takes the position that an untimely filed return does not bar a bankruptcy discharge, this stance can change at any time, and given the split in legal interpretation, it is possible that some courts could ignore the IRS position. In addition, the uncertainty in the bankruptcy law may have an adverse impact on taxpayers with state tax liabilities. As a result, otherwise compliant taxpayers who file late returns may not be able to obtain the fresh start intended by the Bankruptcy Code, or achieve finality in resolving their tax liabilities at the time of the discharge. This may undermine the taxpayers’ *right to finality*.

Recommendation

The National Taxpayer Advocate recommends that Congress clarify the meaning of the Hanging Paragraph language in § 523(a) of the Bankruptcy Code to provide that a late-filed tax return may be considered a return for purposes of obtaining a bankruptcy discharge.

THE MOST LITIGATED ISSUES

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(x) requires the National taxpayer advocate to include in her annual report to congress the ten tax issues most litigated in the federal courts, classified by the type of taxpayer affected. The cases we reviewed were decided during the 12-month period that began on June 1, 2010, and ended on May 31, 2011.

MLI #1 Accuracy- Related Penalty Under IRC §§ 6662(b)(1), (2), and (3)

IRC §§ 6662(b)(1) and (2) authorize the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations caused an underpayment of tax, or if an underpayment exceeded a computational threshold called a substantial understatement, respectively. This year, we also analyzed accuracy-related penalties under IRC § 6662(b)(3) (substantial valuation misstatement) and the increased penalty amount under IRC § 6662(h) for a gross valuation misstatement because during our review period of June 1, 2013, through May 31, 2014, taxpayers litigated these penalties more frequently than in past years. Specifically, we reviewed 12 cases involving IRC § 6662(b)(3), and 14 cases involving IRC § 6662(h). IRC § 6662(b) also authorizes the IRS to impose four other accuracy-related penalties.

MLI #2 Trade or Business Expenses Under IRC § 162 and Related Sections

The deductibility of trade or business expenses has long been among the ten Most Litigated Issues since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998. We identified 115 cases involving a trade or business expense issue that were litigated between June 1, 2013, and May 31, 2014. The courts affirmed the IRS position in 87 of these cases (76 percent), while taxpayers fully prevailed in only three cases (three percent). The remaining 25 cases (22 percent) resulted in split decisions.

MLI #3 Summons Enforcement Under IRC §§ 7602, 7604, AND 7609

Pursuant to IRC § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability. To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information. If a person summoned under § 7602 neglects or refuses to obey the summons, or to produce books, papers, records, or other data, or to give testimony, as required by the summons, the IRS may seek enforcement of the summons in a United States District Court.

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it. Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues because often the government, rather than the taxpayer, initiates the litigation pertaining to summons enforcement. If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons. Generally, the burden on the taxpayer to establish the illegality of the summons is heavy.

We identified 102 federal cases decided between June 1, 2013, and May 31, 2014, that included issues of IRS summons enforcement. Of the 102 cases, the parties contesting the summonses prevailed fully in

two cases, with three other cases resulting in split decisions. The IRS prevailed in full in the remaining 97 decisions.

MLI #4 Gross Income Under IRC § 61 and Related Sections

When preparing tax returns, taxpayers must complete the crucial calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress. For this report, we reviewed 89 cases decided between June 1, 2013, and May 31, 2014. The majority of cases involved taxpayers failing to report items of income, including some specifically mentioned in IRC § 61 such as wages, interest, dividends, and annuities.

MLI #5 Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

Collection Due Process (CDP) hearings were created by the IRS Restructuring and Reform Act of 1998 (RRA 98). CDP hearings provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first NFTL with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.

Since 2001, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed in the National Taxpayer Advocate's Annual Reports to Congress. The trend continues this year, with our review of litigated issues finding 76 opinions on CDP cases during the review period of June 1, 2013, through May 31, 2014.

The cases demonstrate that CDP hearings serve an important function by providing taxpayers with a forum to raise legitimate issues before the IRS deprives them of property. Many of these decisions provide guidance on substantive issues.

CDP hearings are particularly valuable because they provide taxpayers with an enforceable remedy with respect to several rights articulated in the Taxpayer Bill of Rights recently adopted by the IRS in response to National Taxpayer Advocate recommendations. In particular, by providing an opportunity for a taxpayer to challenge the underlying liability and raise alternatives to the collection action, the CDP hearing enforces the taxpayer's *right to challenge the IRS position and be heard*. If the taxpayer does not agree with the Appeals determination, he may file a petition in Tax Court, which furthers the taxpayer's *right to appeal an IRS decision in an independent forum*. Lastly, since the Appeals Officer must consider whether the IRS's proposed collection action balances the overall need for efficient collection of taxes with the legitimate concern that the IRS's collection actions are no more intrusive than necessary, the CDP hearing protects a taxpayer's *right to privacy*.

MLI #6 Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654

We reviewed 56 decisions issued by federal courts from June 1, 2013, to May 31, 2014, regarding the additions to tax for:

- Failure to file a tax return by the due date under IRC § 6651(a)(1);
- Failure to pay an amount shown as tax on a return under IRC § 6651(a)(2);
- Failure to pay estimated tax under IRC § 6654; or
- Some combination of the three.

The phrase “addition to tax” is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Thirteen cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; four involved both the failure to file and failure to pay penalties; one case involved only the estimated tax penalty; three cases involved only the failure to pay penalty; and 30 cases involved only the failure to file penalty.

The IRS imposes the failure to file and failure to pay penalties unless the taxpayer can demonstrate the failure is due to reasonable cause and not willful neglect. The estimated tax penalty is imposed unless the taxpayer can meet one of the statutory exceptions. Taxpayers were unable to avoid a penalty in 49 of the 56 cases.

MLI #7 Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

IRC § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or subject any of the delinquent taxpayer’s property to the payment of tax. We identified 52 opinions issued between June 1, 2013, and May 31, 2014, that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 47 of these cases. The total number of cases represents a 58 percent increase from the previous year.

MLI #8 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

From June 1, 2013, through May 31, 2014, the federal courts issued decisions in at least 22 cases involving the IRC § 6673 “frivolous issues” penalty, and at least ten cases involving analogous penalties at the appellate level. These penalties may be imposed against taxpayers for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal. In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future. Nonetheless, we include these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

MLI #9 Charitable Deductions Under IRC § 170

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes for contributions of cash or other property to or for the use of charitable organizations. In order to take a charitable deduction, taxpayers must contribute to a qualifying organization and substantiate contributions of \$250 or more. Litigation generally arises over one or more of these four issues:

- Whether the donation is made to a charitable organization;
- Whether contributed property qualifies as a charitable contribution;
- Whether the amount taken as a charitable deduction equals the fair market value of the property contributed; and
- Whether the taxpayer has substantiated the contribution.

We reviewed 30 cases decided between June 1, 2013, and May 31, 2014 with charitable deductions as a contested issue. The IRS prevailed in 25 cases, with taxpayers prevailing in no cases and the remaining five resulting in split decisions. Taxpayers represented themselves (appearing *pro se*) in 13 of the 30 cases (43 percent), with two of these *pro se* cases resulting in split decisions and the IRS prevailing in the remaining 11 cases.

MLI #10 Passive Activity Losses (PAL) Under IRC § 469

This is the first time the disallowance of the passive activity loss and credit (PAL) under IRC § 469 has been among the Most Litigated Issues in the National Taxpayer Advocate's Annual Report to Congress. A possible explanation for this increase in cases may be the IRS having nine Compliance Initiative Programs (CIP) between the tax years of 2007-2012, which specifically addressed compliance issues involving PAL. We identified and reviewed 28 federal court opinions involving a PAL issue that were issued between June 1, 2013 and May 31, 2014. The 28 opinions do not reflect the full number of PAL cases because the courts do not always publish an opinion. Some cases are resolved through settlements, or taxpayers do not pursue litigation after filing a petition or complaint with the court. The courts also dispose of some cases by issuing unpublished orders. The courts affirmed the IRS position in the vast majority of cases (23 out of 28, approximately 82 percent), while taxpayers fully prevailed only about 14 percent of the time (in four out of 28 cases). The remaining case resulted in a split decision.

VOLUME 2: TAS RESEARCH AND RELATED STUDIES

#1 LOW INCOME TAXPAYER CLINIC PROGRAM: A Look at Those Eligible to Seek Help from the Clinics

Introduction

The Low Income Taxpayer Clinic (LITC) Program provides tax representation or advice to low income individuals who need help resolving issues with their federal income tax returns. Low Income Taxpayer Clinics were established to assure that low income taxpayers have access to justice and are treated fairly. Internal Revenue Code (IRC) § 7526(b)(1)(B)(i) requires that at least 90 percent of the taxpayers represented by an LITC must have incomes that do not exceed 250 percent of the federal poverty level. LITCs provide *pro bono* representation to taxpayers in tax disputes with the IRS, educate low income and English is a second language (ESL) taxpayers about their rights and responsibilities, and identify and advocate for solutions to systemic issues that affect these taxpayers. Thus, LITCs are central to the realization of two important taxpayer rights: the *right to retain representation* and the *right to a fair and just tax system*.

Objectives

This study was developed with the goal of learning more about taxpayers who are eligible for help from LITCs. First, TAS wanted to know if taxpayers are aware of these clinics and what issues lead them to seek LITC help. TAS sought additional information about personal tax situations such as whether the taxpayer used a preparer or received correspondence from the IRS, and how the individual responded to IRS letters. The survey also gathered information about participants' home technology capabilities and how they preferred to work with LITCs.

Methodology

The National Taxpayer Advocate, who oversees and administers the LITC program for the IRS, commissioned a study to better understand the needs and circumstances of taxpayers eligible to use the clinics. To ensure coverage of the LITC-eligible population, this Random Digit Dialed (RDD) survey used both landline and cell phone numbers to contact more than 1,100 low income individuals. The survey is representative of the low income population, defined by household income at or below 250 percent of the federal poverty level, as well as Spanish speakers of this population. It gathered information on eligible taxpayers' awareness and use of LITC services, the types of issues for which they would consider using clinics, demographic information, and other items.

Findings

Characteristics of Eligibles

- **Preparer Use:** About half of all LITC-eligibles hired a tax preparer to complete their federal tax return, as did 75 percent of Spanish speakers.
- **Language:** More than 90 percent of all respondents stated they prefer to discuss their taxes in English, compared to about 20 percent of Spanish speakers. Over 75 percent of Spanish Speakers report that they prefer speaking Spanish during tax discussions.
- **Education:** A majority of all eligibles have some college experience. There are differences in this measure by total vs. Spanish speaking, with Spanish speakers having considerably lower education levels. Specifically, over 30 percent of Spanish speakers' highest level of education was less than a

high school degree, with 29 percent reporting only an Elementary school education, compared to less than ten percent of the total eligible (only three percent reporting just an Elementary school education).

- **Disability:** Overall, about one-fifth of all eligibles reported having a long-term disability.

Eligibles' Awareness and Use of LITCs

- **Awareness of LITCs:** Only about 30 percent of all eligibles were aware of an organization outside the IRS that helps taxpayers with IRS problems. Among those aware, only about ten percent knew the name of the organization is “Low Income Taxpayer Clinic.”
- **Use of LITCs:** About two of every three LITC eligibles stated they were likely or very likely to use an LITC if they had a need for its services.
- **Interactions with LITCs:** Participants indicated they were willing to travel 20-30 minutes to a clinic. In-person meetings and meetings at a community services center were preferred by over 75 percent of all eligibles. Only about ten percent of all eligible taxpayers were willing to interact by computer or videoconference. Spanish speakers were twice as willing as the total group to videoconference

Conclusion: Significance of Findings for IRS Taxpayer Service Available to Vulnerable Taxpayers

The LITC Survey findings and other studies show that technology adoption and use are not the same across incomes, education levels, age groups, and several other factors. The findings also demonstrate that the low-income population is vulnerable and more likely than the population at large to be taken advantage of by unskilled or unscrupulous tax return preparers. For example, over 15 percent of those relying on a preparer either did not receive a copy of their return or the preparer did not sign the return. In other words, for nearly one in six low income taxpayers who used preparers, their preparers did not follow the basic statutory requirements established for commercial tax preparation.

The National Taxpayer Advocate continues to harbor concern about the IRS's future direction for taxpayer services, primarily that the IRS will make service-related policy decisions that will leave this vulnerable population behind. As the IRS moves away from traditional in-person services such as live telephone assistance or face-to-face interactions at Taxpayer Assistance Centers, some groups of taxpayers will be impacted more than others.

Taxpayers who have viable service alternatives or do not rely on the IRS for help will experience minimal impediments in meeting their tax obligations. However, those who do rely on the IRS may have difficulty or be unable to move to new technologies and service channels. These types of service reductions increase the value of and the critical need for services among low income taxpayers.

Studies show preferences for services and delivery methods differ by various service users. LITCs need to know their clients' preferred communication mediums and service needs to effectively help their clients and those eligible for their services.

#2 ESTIMATING THE IMPACT OF AUDITS ON THE SUBSEQUENT REPORTING COMPLIANCE OF SMALL BUSINESS TAXPAYERS: Preliminary Results

Introduction

TAS Research is working on a multi-year study to identify the major factors that drive taxpayer compliance behavior. During the first two study phases, we analyzed the results of a telephone survey, conducted by a vendor, using a representative national sample of taxpayers with sole proprietor income (*i.e.*, Schedule C, *Profit or Loss from Business (Sole Proprietorship)*). There were a number of significant study findings, including that trust in government, the tax laws, and the IRS are associated with the level of taxpayer compliance. Surprisingly, however, TAS found no significant evidence that economic deterrence (*i.e.*, the expected likelihood and cost of getting caught cheating) motivates sole proprietor compliance decisions.

In the current study phase, TAS is again exploring whether economic deterrence impacts future sole proprietor tax compliance, because statistics show underreporting of individual business income represents the largest portion of the tax gap (*i.e.*, taxes not voluntarily and timely paid). Specifically, we are evaluating the impact of audits on the subsequent reporting compliance of sole proprietors.

The IRS generally needs to conduct audits to detect noncompliance by sole proprietors, since most sole proprietor income is not subject to third-party information reporting and therefore, cannot be detected by document matching. Thus, it is important for the IRS to gain a better understanding of how to improve compliance among sole proprietors, and in particular, to evaluate the effectiveness of its current audit strategy.

Objectives

The principal study objective is to evaluate the impact of audits on the subsequent reporting compliance of sole proprietor taxpayers. TAS also explored whether certain factors related to the audit appear to influence subsequent reporting compliance, including:

- The type of audit, *i.e.*, correspondence, field audit or office audit;
- The amount of the audit assessment; and
- Prior and subsequent audits of the test group taxpayers, *i.e.*, those audited in year one of the study.

Methodology

TAS Research evaluated reporting compliance using the IRS's computer algorithms (called a Discriminant Index Function or "DIF" score) that estimates the likelihood that an audit of the taxpayer's return would produce an adjustment (*i.e.*, a higher DIF generally corresponds to lower reporting compliance).

TAS Research used a test group and a separate control group to evaluate changes in reporting compliance over a five year period. The test group was comprised of the nearly 68,000 sole proprietor taxpayers (*i.e.*, taxpayers with Schedule C income) with high DIF scores. We classified taxpayers with DIF scores in the top 20 percent as high DIF score taxpayers. We found 67,859 high DIF score sole proprietor taxpayers whose audits closed in calendar year 2007. who were audited and had their audits closed in calendar year 2007, the first study year. The control group was the population of over 2.3 million sole proprietor taxpayers with high DIF scores who were not audited in the first year of the study. To detect changes in reporting compliance, we tracked the test groups' DIF scores for the five years following the audit and compared them to the control groups' DIF scores during the same period.

Findings

Our study findings suggest that overall IRS audits have a modest deterrent effect that diminishes in the years following the audit, disappearing altogether by year five. This suggests that any initial impact of the audit on compliance is short lived. These findings are consistent with previous TAS studies that explored factors that influence compliance behavior of sole proprietor taxpayers. In those studies, TAS failed to find evidence that deterrence significantly influences the compliance behavior of sole proprietor taxpayers.

Current study findings suggest, however, that the deterrent effect may vary due to factors such as the type of audit and the amount of the audit assessment relative to the taxpayer's total positive income. In particular, our findings suggest that field and office audits may be more effective than correspondence audits in promoting subsequent reporting compliance. Also, audits with large assessments, relative to the taxpayer's total positive income, appear to be more effective in promoting subsequent reporting compliance. Based on our current analyses, it is unclear whether these large assessments are due to more effective audits or lower taxpayer reporting compliance.

Our findings also suggest that there may be a group of taxpayers who are particularly resistant to the deterrent effect of audits, since these taxpayers continue to have higher DIF scores than other audited taxpayers despite being audited more than once during the study period.

In this report, we present our preliminary study findings. TAS Research is working with independent researchers to further explore the impact of audits on taxpayer compliance behavior. Based on their preliminary review of this study, we anticipate working with them to explore:

- Refinement of the control group, *i.e.*, the population of sole proprietor taxpayers with high DIF scores who were not audited in 2007, by removing taxpayers who were audited in the years immediately preceding 2007 (the beginning of the study period) or during the study period;
- Whether the classification process that determines the type of audit, *i.e.*, correspondence, office, or field audit, introduced a selection bias that we should address with refinements to our analysis of the subsequent reporting compliance behavior of the taxpayers in these audit groups;
- Possible explanations for the significant decline of both the treatment and control groups' DIF scores in the year following the audit;
- A more detailed analysis of the impact of multiple audits that considers both the number and timing of the audits with respect to the audit that closed in 2007; and
- Alternative methodologies, such as panel regression, that would enable the addition of control variables (e.g., demographic variables such as type of business, gender and age and other variables such as prior audit experience) to better isolate and distinguish the impact of the audit from other potential factors. For an in-depth discussion of the need for inclusion of demographic and other behavioral economic factors in the IRS workload selection process, see Most Serious Problem: *WORKLOAD SELECTION: The IRS Does Not Sufficiently Incorporate the Findings of Applied and Behavioral Research into Audit Selection Processes as Part of an Overall Compliance Strategy, supra.*

We anticipate publishing the results of this collaborative effort by the end of 2015. We will also collaborate with these researchers throughout 2015 on new studies evaluating the impact of penalties and outreach and education on taxpayer compliance behavior.

#3 IDENTITY THEFT CASE REVIEW REPORT: A Statistical Analysis of Identity Theft Cases Closed in June 2014

Introduction

In general, tax-related identity theft (IDT) occurs when an individual intentionally uses the personal identifying information of another person to file a falsified tax return with the intention of obtaining an unauthorized refund. The National Taxpayer Advocate is concerned that a significant percentage of the IRS's IDT cases involve multiple issues, some of which must be addressed by multiple IRS organizations, requiring victims to navigate a labyrinth of IRS operations and recount their experience time and again to different employees. Even when cases remain in one IRS function, they may be transferred from one assistor to another with significant periods of non-activity. We are also concerned that the IRS may close IDT cases prematurely, before all related issues have been fully addressed. In this review, we attempt to get a better sense of the true IDT cycle time—the time it takes to fully resolve the IDT victim's account, measured from the perspective of the victim.

Analysis

TAS pulled a representative sample of IDT cases from IRS inventory and reviewed 409 cases (or “modules” in IRS parlance), impacting 389 taxpayers, that received a closing code in June 2014. We discovered that 15 percent of the sampled taxpayers had additional modules with open IDT issues in prior or subsequent years, for which data was not available to analyze. We also found the existence of an account closure marker does not necessarily mean the IRS had resolved all related issues. In fact, the IRS prematurely closed cases for 22 percent of the IDT victims in our sample. Thus, the cycle time calculated in our case review is understated.

Findings

Here are some of our findings:

1. The majority of IDT victims had tax issues impacting just a single year.
2. Almost 30 percent of IDT cases involved multiple issues.
3. The majority of IDT cases were worked within a single IRS function, but this observation reflects the IRS's definition of all compliance functions—including examination and collection—as a single function.
4. Two-thirds of IDT cases were transferred or reassigned.
5. From the taxpayer's perspective, the average cycle time was nearly six months (179 days).
6. The IRS closed more than one-fifth of its IDT cases before all issues were resolved.

Recommendations

Based on the findings, the National Taxpayer Advocate recommends:

1. Functions working IDT cases should conduct a global account review upon case receipt and handle only single-issue IDT cases.
2. IDT victims with multiple issues should be assigned a sole IRS contact person (and provided with a toll-free direct extension to this person) who would work with them throughout and oversee the resolution of the case, no matter how many different functions are involved behind the scenes.

3. The IRS should count each function that works IDT cases separately, rather than lumping eight different functions into a catchall “compliance” bucket for purposes of its multiple function criteria.
4. The IRS should track IDT cycle time in a way that reflects the taxpayer’s experience more accurately—from the time the taxpayer submits the appropriate documentation to the time the IRS issues a refund (if applicable) or otherwise resolves all related issues.
5. The IRS should review its global account review procedures to ensure all related issues are actually resolved (including issuance of a refund, if applicable) prior to case closure, and conduct appropriate training for its employees.



YOUR VOICE AT THE IRS

