

I. Introduction

The Internal Revenue Code requires the National Taxpayer Advocate to submit two annual reports to the House Committee on Ways and Means and the Senate Committee on Finance.¹ The National Taxpayer Advocate is required to submit these reports directly to the Committees without any prior review or comment from the Commissioner of Internal Revenue, the Secretary of the Treasury, or the Office of Management and Budget.² The first report, due by June 30 of each year, must identify the objectives of the Office of the Taxpayer Advocate for the fiscal year beginning in that calendar year.³

In any given year, the Internal Revenue Service (IRS) must balance demands from a trifecta of sources — the taxpaying public; congressional and other overseers; and the IRS itself, which constantly struggles to meet its increasing workload with limited resources. There is much in the following report and elsewhere that demonstrates the IRS has achieved considerable success in addressing the concerns of these participants in tax administration. The successful implementation of CADE 2,⁴ the beginning of Virtual Service Delivery⁵ and Fresh Start collection policies,⁶ and the maturation of return-preparer regulation⁷ are evidence that the IRS can heed its stakeholders' concerns even as it introduces new processes and approaches to its workplace.

But this report also contains ample evidence that satisfying these three sources simultaneously can be difficult and that failure in one area can seriously and negatively impact the other two. For example, our first Area of Focus, *Late-Year Tax Law Changes May Delay Tax Filings and Refunds Early Next Year*, describes how an aura of uncertainty prevails as the IRS and taxpayers wait for word about what will be the law governing us this year and for the near future. This uncertainty affects the IRS's ability to smoothly administer the filing season and taxpayers' ability to make plans. In fact, the IRS has had to plan for at least two distinct scenarios in three recent filing seasons, essentially doubling its work and drawing focus and resources from other important projects. The continual enactment of significant tax law and extender provisions late in the year has led to IRS delays in handling millions of taxpayers' returns and caused many taxpayers to underclaim benefits because they did not know what the law was, and IRS forms and instructions did not reflect the late-enacted provisions.

1 Internal Revenue Code (IRC) § 7803(c)(2)(B).

2 IRC § 7803(c)(2)(B)(iii).

3 IRC § 7803(c)(2)(B)(i).

4 See *CADE 2 Implementation – Unintended Consequences*, *infra*.

5 See *TAS Is Participating in the IRS's Virtual Services Delivery (VSD) Pilot*, *infra*.

6 See *Collection Update: IRS "Fresh Start" Initiatives – Significant Changes Have Been Made, but Further Improvements Are Needed*, *infra*.

7 See National Taxpayer Advocate 2011 Annual Report to Congress 427-436 (Status Update: *The IRS Has Made Significant Progress in Developing and Implementing a System to Register and Test Return Preparers*).

We are also seeing an increasing collision between two competing policy goals that no one seems willing to address. With the onslaught of organized efforts to defraud taxpayers and the public fisc through identity theft and other schemes (including those perpetrated by return preparers), the IRS must somehow prevent refunds from going out on over two million bogus claims — and at the same time quickly process returns and issue refunds to the over 145 million individual taxpayers who file legitimate claims.

I am not sure how the IRS can successfully reconcile these concerns under our current filing season structure.⁸ While Congress and taxpayers rightfully demand that the IRS stop payment on fraudulent refund claims, Congress and taxpayers also rightfully demand that the IRS pay refunds out to legitimate taxpayers immediately. As the IRS develops more screens to identify and delay the processing of refund returns that appear questionable, more taxpayers are getting caught up in more delays.⁹ Once a return is deemed suspect, an IRS employee at some point must look at the return. As we discuss in this report, the IRS is experiencing unprecedented backlogs in return processing because of identity theft¹⁰ and other refund fraud, is instituting “hard freezes” on questionable returns because it cannot timely address them,¹¹ and is unable to answer anywhere from an average of about 30 percent overall in fiscal year (FY) 2012 to a low of 65 percent of calls on one product line.¹²

The filing season frustration is only the beginning of taxpayer frustration. In both post-filing examination and collection activities, the IRS is increasingly using automation to distance itself from communicating personally with taxpayers. In fact, as we discuss in this report, most taxpayers will never receive a call from the IRS before the IRS proposes an assessment of tax or levies on their assets or incomes.¹³ Taxpayers’ patience is being sorely tested, and this impersonal work environment cannot be pleasant for IRS employees, either. In many ways, we seem to be reliving the years preceding enactment of the IRS Restructuring and Reform Act of 1998.¹⁴

8 I have suggested that the IRS and Congress explore the possibility of moving the issuance of refunds back to a date after the close of the filing season, as is the practice in several other countries. This approach will not be pain-free, since taxpayers over the years have come to expect to receive their refunds almost immediately upon filing their returns. But the benefits of such an approach require us at least to explore its advantages and disadvantages from both the government and taxpayer perspectives. See *The IRS Should Take Steps to Limit Opportunities for Refund Fraud, While Not Unreasonably Delaying Legitimate Refund Claims*, *infra*; *Identity Theft and Tax Fraud*, Hearing Before the Subcomm. on Oversight and Social Security, H. Comm. on Ways and Means, 112th Cong. (May 8, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); *Tax Compliance and Tax-Fraud Prevention*, Hearing Before the H. Comm. on Oversight and Government Reform, Subcomm. on Government Organization, Efficiency, and Financial Management, 112th Cong. (Apr. 19, 2012) (statement of Nina E. Olson, National Taxpayer Advocate).

9 See *Tax-Related Identity Theft Work Continues to Increase within TAS*, *infra*; *The Questionable Refund Program Results in Significant Delays in Processing Tax Refunds*, *infra*; *Adoption Credit Filing and Examination Procedures Placed Unnecessary Burdens on Taxpayers*, *infra*.

10 See *The IRS’s Identity Theft Victim Assistance Strategy Requires Additional Improvements and Continued Oversight*, *infra*.

11 See *The IRS Should Take Steps to Limit Opportunities for Refund Fraud, While Not Unreasonably Delaying Legitimate Refund Claims*, *infra*.

12 See Joint Operations Center, Snapshot Reports (week ending June 9, 2012). For example, the Taxpayer Protection Unit, which was established in the 2012 filing season to respond to calls from taxpayers whose returns were flagged and held by identity theft filters, was able to answer just 35 percent of incoming calls, and those who managed to get through to a telephone assister had to wait an average of 40 minutes to get through to an assistor. See *Filing Season Effects of Reduced Funding for Taxpayer Service*, *infra*.

13 See *Improve Automated Examination Procedures*, *infra*; *Collection Update: IRS “Fresh Start” Initiatives – Significant Changes Have Been Made, but Further Improvements Are Needed*, *infra*.

14 Pub. L. No. 105-206, 112 Stat. 685 (1998).

So where is the Taxpayer Advocate Service in all this? Well, we continue to advocate for taxpayers both individually and collectively. From a case advocacy perspective, we received about 296,000 cases in FY 2011 from taxpayers who were experiencing problems with the IRS. From a systemic advocacy perspective, we pursue well over 100 advocacy projects internally within the IRS each year, provide hundreds of comments on draft Internal Revenue Manual provisions (most of which are accepted), and report to Congress twice yearly on how the tax administration system is working from a taxpayer perspective.

Over the last few years, TAS also has made increasing use of its Taxpayer Assistance Order (TAO)¹⁵ and Taxpayer Advocate Directive (TAD)¹⁶ authority to advocate for sound administrative policy and procedures. In an ideal world, once TAS identifies individual or systemic problems and makes recommendations to mitigate them, the IRS and TAS would collaborate to address our concerns. In practice, the IRS is subject to many competing pressures, and our concerns are sometimes given low priority.

In the past, TAS issued TAOs in cases very rarely and without regard to broader advocacy considerations. Over the last three years, we have developed and implemented a strategic approach for issues that arise in multiple TAS cases, that are the subject of many systemic advocacy projects and cross-functional teams, and about which we have repeatedly sought solutions from the IRS, to no avail. This approach includes:

- *Case Advocacy:* When an issue of this nature arises, the National Taxpayer Advocate issues interim guidance to her employees, analyzing how to advocate with respect to the issue and providing sample language and template TAOs. Case advocacy employees then implement this guidance in individual cases, including the issuance of well-developed TAOs. These cases provide concrete evidence of the harm taxpayers experience as a result of IRS action or inaction. The issuance of TAOs means that if the IRS disagrees with TAS's recommendation in a case, it must appeal the TAO to the next level of management, thereby increasing the visibility of the problem.
- *Systemic Advocacy:* The National Taxpayer Advocate issues proposed and final TADs to the highest levels of IRS leadership, providing analysis and recommendations, and directing resolution of the problem. TAS systemic advocacy employees continue to negotiate with IRS functional personnel in these cases.
- *Research:* TAS Research conducts empirical studies and analyses of IRS and TAS data (often involving representative samples of the impacted populations) to quantify impact and identify root causes of the problems, and to make systemic recommendations.

15 IRC § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order upon a determination that a taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary.

16 Pursuant to Delegation Order No. 13-3, the National Taxpayer Advocate has the authority to issue a TAD to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers. Internal Revenue Manual (IRM) 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

- *Transparency*: The National Taxpayer Advocate discusses these issues in her Annual Reports to Congress, with publication of relevant TADs and research studies, and in Congressional testimony.

TAS has applied this approach successfully with respect to several issues, including the IRS's lien filing and withdrawal policies.¹⁷ As a consequence of our advocacy, the IRS has increased the dollar thresholds for lien filings and reversed its decades-old policy on lien withdrawals after lien releases.¹⁸ We are now applying this approach to the Offshore Voluntary Disclosure settlement initiatives,¹⁹ Earned Income Tax Credit examinations,²⁰ and Return Preparer Fraud cases.²¹

To me, this advocacy activity represents the maturation of TAS — where the issuance of a TAO is no longer a rarity but is viewed as an important tool to help bring about systemic change. Not unexpectedly, this vigorous advocacy has met with IRS challenges to the National Taxpayer Advocate's TAO and TAD authority. These challenges are, in my opinion, legally flawed and bad policy. The purpose of TAOs and TADs is to ensure that issues that may impinge on taxpayer rights or impose excessive taxpayer burden are elevated for consideration to the highest levels of the IRS leadership in a formal way that requires a written response, so that the issues and competing considerations are made transparent to Congress and other stakeholders.

In the case of both TAOs and TADs, the IRS Commissioner or Deputy Commissioner may ultimately overturn whatever action the National Taxpayer Advocate directs. For that reason, it is utterly mystifying to me why the IRS would seek to squelch the authority of the National Taxpayer Advocate to raise taxpayer rights and taxpayer burden issues to the

17 See National Taxpayer Advocate, *Interim Guidance Memorandum*, Control No. TAS-13.1-0310-003 (Mar. 31, 2010). For a copy of this memorandum, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix IX, available at <http://www.irs.gov/pub/irs-utl/nta2011objectives-final.pdf>; National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 91-111 (TAS Research Study: *Estimating the Impact of Liens on Taxpayer Compliance Behavior and Income*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 1-18 (TAS Research Study: *The IRS's Use of Notices of Federal Tax Lien*); *Estimating the Impact of Liens on Taxpayer Compliance Behavior*, *infra*; National Taxpayer Advocate 2011 Annual Report to Congress 109-128; National Taxpayer Advocate 2010 Annual Report to Congress 302-310; National Taxpayer Advocate 2009 Annual Report to Congress 17-40. See also TAD 2010-1, *Immediately discontinue automatic lien filing on Currently Not Collectible (CNC) hardship accounts with an unpaid balance of \$5,000 or more, require employees to make meaningful notice of federal tax lien (NFTL) filing determinations, and require managerial approval for filings of an NFTL in all cases where the taxpayer has no assets* (Jan. 20, 2010); TAD 2010-2, *Withdrawal of a notice of federal tax lien (NFTL) where the statutory withdrawal criteria are satisfied, even if the underlying lien has been released* (Jan. 20, 2010). For copies of the TADs, see National Taxpayer Advocate Fiscal Year 2011 Objectives Report to Congress, Appendix VIII, available at <http://www.irs.gov/pub/irs-utl/nta2011objectivesfinal.pdf>. In FY 2011, TAS issued 27 TAOs pertaining to liens (issue codes 720 through 729). In FY 2012 (through May 31, 2012), TAS issued 11 TAOs pertaining to liens.

18 For a detailed discussion of this issue, see IRS Office of Chief Counsel, *Withdrawal of NFTL After Release*, PMTA 2009-158 (Oct. 9, 2009) and National Taxpayer Advocate 2011 Annual Report to Congress 109-128. See also *Collection Update: IRS "Fresh Start" Initiatives – Significant Changes Have Been Made, but Further Improvements Are Needed*, *infra*.

19 See *TAS Will Continue to Advocate that the IRS Modify the Offshore Voluntary Disclosure Program So that People Who Made Honest Mistakes Can Correct Them Without Fear of Excessive Penalties*, *infra*.

20 See *Earned Income Tax Credit (EITC) Examination Effectiveness*, *infra*; Memorandum for Taxpayer Advocate Service Employees, *Interim Guidance on Advocating for Taxpayers Claiming Earned Income Tax Credit (EITC) with Respect to a Qualifying Child* (Feb. 9, 2012) available at <http://www.irs.gov/pub/foia/ig/tas/tas-13-0212-006.pdf>.

21 See *Improve Tax Administration through Taxpayer Advocate Directives*, *infra*.

senior IRS leadership in this way, and we certainly will not accede to attempts to constrain our advocacy efforts of behalf of our nation's taxpayers.²²

Now, more than ever, with all the competing demands on the IRS, taxpayers need a strong and effective voice inside the IRS. The strategic approach TAS is now taking represents the fulfillment of its statutory mission. So, in fiscal year 2013, as discussed throughout this report, TAS will continue to advocate to the best of its ability on behalf of U.S. taxpayers, both individually and collectively.

Respectfully submitted,



Nina E. Olson
National Taxpayer Advocate
27 June 2012

²² In the 2011 Annual Report to Congress, we make several legislative recommendations to strengthen and clarify the National Taxpayer Advocate's TAO and TAD authority, including a recommendation to codify the TAD. See National Taxpayer Advocate 2011 Annual Report to Congress 573-581 (Legislative Recommendation: *Codify the Authority of the National Taxpayer Advocate to File Amicus Briefs, Comment on Regulations, and Issue Taxpayer Advocate Directives*).