MISCELLANEOUS RECOMMENDATIONS

Legislative Recommendation #51

Restructure the Earned Income Tax Credit (EITC) to Make It Simpler for Taxpayers and Reduce Improper Payments

SUMMARY

- *Problem:* The Earned Income Tax Credit (EITC) is one of the federal government's largest anti-poverty programs, but its eligibility requirements are complex. As a result, millions of eligible taxpayers fail to claim the EITC, while other taxpayers claim amounts for which they are not eligible, leading to a high "improper payments" rate.
- *Solution:* Simplify the EITC by separating it into a "worker credit" and a "child credit," remove age limits for claiming the EITC, and treat unemployment compensation as earned income.[1]

PRESENT LAW

The EITC is a refundable tax credit for low- and moderate-income working individuals and families.[2] Eligibility for the EITC and the amount of EITC a taxpayer may claim are based on a variety of factors, including the taxpayer's earned income, the number of qualifying children, and the taxpayer's filing status. The EITC is not available to taxpayers who have disqualified income (*e.g.*, investment income such as dividends, capital gains, and rental income) that exceeds the applicable limit ($11,600 for tax year (TY) 2024).[3] Taxpayers without qualifying children may claim the EITC (commonly referred to as the "childless EITC"), but only if they are between the ages of 25 and 64.[4]

The EITC is structured so that as earned income rises, the credit phases in, plateaus at a maximum amount, and then phases out. The phase-in, maximum, and phase-out amounts depend on the taxpayer's filing status and the number of qualifying children. The maximum credit for TY 2024 is $632 if the taxpayer has no qualifying children, $4,213 with one qualifying child, $6,960 with two qualifying children, and $7,830 with three or more qualifying children.[5]

An individual must meet three primary requirements to be a taxpayer's qualifying child for the EITC.[6] First, the individual must have a specific blood or legal relationship to the taxpayer.[7] Second, the individual must

1 The National Taxpayer Advocate also recommends that Congress simplify and update the definition of "qualifying child" as used in the EITC and other tax provisions to reflect modern family structures. *See Adopt a Consistent and More Modern Definition of "Qualifying Child" Throughout the Internal Revenue Code, infra*.

2 IRC § 32.

3 IRS, Earned Income and Earned Income Tax Credit (EITC) Tables (Aug. 26, 2024), https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-and-earned-income-tax-credit-eitc-tables.

4 IRC § 32(c)(1)(A)(ii).

5 IRS, Earned Income and Earned Income Tax Credit (EITC) Tables (Aug. 26, 2024), https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-and-earned-income-tax-credit-eitc-tables.

6 Where there are competing claims for the same child, "tie breaker" rules prioritize the claims. IRC § 152(c)(4)(B).

7 IRC §§ 32(c)(3)(A), 152(c)(2).

share a residence in the United States with the taxpayer for more than half the year.[8] Third, the individual must be under the age of 19 (or under age 24 if a full-time student) or be permanently and totally disabled.[9]

Unemployment compensation (UC) is based on a taxpayer's earned income and is included in adjusted gross income (AGI) under IRC § 85, but it is generally *not included* in earned income under IRC § 32 and thus does not count in computing the amount of EITC for which a taxpayer is eligible.

REASONS FOR CHANGE

Enacted in 1975, the EITC is one of the federal government's largest anti-poverty programs for low-income workers.[10] For TY 2022, taxpayers filed over 23 million returns claiming EITC benefits worth about $61 billion.[11] Overall, the EITC is considered to be an effective anti-poverty program, but its eligibility requirements are complex. As a result, some taxpayers who are eligible for the credit fail to claim it, missing out on this important benefit.[12] At the same time, the program suffers from a relatively high rate of improper payments that could be reduced if the eligibility requirements were simplified.[13]

Restructure EITC as Two Credits: A Worker Credit and a Child Credit

The National Taxpayer Advocate recommends restructuring the EITC into two credits: (i) a refundable *worker credit* based on each individual worker's earned income, irrespective of the presence of a qualifying child, and (ii) a refundable *child credit* that would reflect the costs of caring for one or more children.

Worker Credit. Much like the current EITC, the worker credit would phase in as a percentage of earned income, reach a plateau, and then phase out.[14] Unlike the current EITC, the credit amount would depend solely on income and would not vary based on whether the taxpayer is claiming one or more qualifying children. Increasing the worker component of the EITC would provide a greater incentive to work, which is a main objective of the credit. This change could also substantially reduce improper payments. The IRS receives Forms W-2 and other information reporting documents directly from employers and other payors of income. For that reason, it can accurately verify income amounts for EITC recipients who are employees, who constitute by far the largest group of EITC claimants.[15]

Child Credit. The child credit would be designed as a fixed amount per qualifying child, subject to an AGI phase-out, and would replace the portion of the existing EITC that is based on the number of qualifying children. It could be consolidated with or replace the Child Tax Credit (CTC). This could be accomplished in various ways, and proposals to expand the CTC might provide a starting point for developing the new

8 IRC § 32(c)(3)(C).

9 IRC §§ 32(c)(3)(A), 152(c)(3). The individual must also have a Social Security number that is valid for employment. IRC § 32(c)(3)(D), (m).

10 *See, e.g.*, Nicardo McInnis et al., *The Intergenerational Transmission of Poverty and Public Assistance: Evidence from the Earned Income Tax Credit* 5-6 (Nat'l Bureau of Econ. Rsch., Working Paper No. 31429, 2023), https://www.nber.org/papers/w31429 (highlighting analyses of the credit's impacts on low-income workers).

11 IRS, Compliance Data Warehouse, Individual Return Transaction File, TY 2022 (Aug. 22, 2024).

12 Approximately 20 percent of eligible taxpayers do not claim the EITC. *See* IRS, EITC Participation Rate by States Tax Years 2014 through 2021 (Aug. 9, 2024), https://www.eitc.irs.gov/eitc-central/participation-rate-by-state/eitc-participation-rate-by-states.

13 An improper payment is generally "any payment that should not have been made or that was made in an incorrect amount, including an overpayment or underpayment, under a statutory, contractual, administrative, or other legally applicable requirement" and includes "any payment to an ineligible recipient." 31 U.S.C. § 3351(4). For fiscal year 2023, the IRS estimates that nearly 33 percent of the total EITC program payments were improper. Payment Accuracy, Fiscal Year 2023 (Jan. 23, 2024).

14 For examples regarding how a per-worker credit might be structured, see Elaine Maag, Urban Inst., Investing in Work By Reforming the Earned Income Tax Credit (2015), https://www.urban.org/research/publication/investing-work-reforming-earned-income-tax-credit.

15 A relatively small percentage of EITC claimants are self-employed individuals. The IRS generally receives less information from third-party payors with respect to self-employed individuals.

credit.[16] The National Taxpayer Advocate also recommends that Congress standardize and modernize the definition of "qualifying child" used in the tax code, which is discussed in a separate Legislative Recommendation.[17]

Remove Age Eligibility Restrictions

As described above, the childless EITC is generally available only to taxpayers between the ages of 25 and 64. For 2021 only, Congress expanded the age range of eligible workers to include adults over the age of 18 (age 24 for students) and made qualified homeless and former foster youth eligible to claim the credit at age 18.[18] The National Taxpayer Advocate recommends making the 2021 changes permanent. There are an estimated 33 million individuals under the age of 25 and over the age of 64 who are participating in the workforce, which includes about 22 million individuals under the age of 25 and about 11 million individuals over the age of 64.[19] Consistent with the EITC program's dual mission of alleviating poverty and providing a work incentive, individuals who are over the age of 18 (age 24 for students) should not be excluded from EITC eligibility. Further, the age limit should be reduced to age 18 for qualified homeless and former foster youth due to the particular challenges these individuals face.

Unemployment Compensation

Taxpayers who receive UC based on their employment earnings cannot use their UC income to qualify for the EITC. The apparent rationale for not counting UC is that the EITC was designed largely to provide a work incentive. However, UC is paid exclusively to individuals who were working and became separated from their jobs due to no fault of their own. During the COVID-19 pandemic, for example, millions of individuals lost their jobs when certain segments of the economy, including restaurants, hotels, and airlines, substantially reduced their workforces. In other instances, local disasters such as hurricanes, tornadoes, and wildfires adversely affect segments of the economy and lead to mass layoffs. Because UC is effectively a replacement for a portion of the wages working individuals would have earned if they had not been separated from their jobs and because UC benefits are only paid for a limited number of months, treating UC as earned income solely for purposes of the EITC would provide additional support for low-income families, while still maintaining the nexus between working and receiving the EITC.[20]

RECOMMENDATIONS

- Separate the EITC into two refundable components: a worker credit and a child credit.[21]

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16 *See*, *e.g.*, American Family Act, H.R. 3899, 118th Cong. § 2 (2023); Working Families Tax Relief Act of 2023, S. 1992, 118th Cong. § 201 (2023); Press Release, Office of Sen. Mitt Romney, *Romney, Burr, Daines Announce Family Security Act 2.0* (June 15, 2022), https://www.romney.senate.gov/romney-burr-daines-announce-family-security-act-2-0.

17 *See Adopt a Consistent and More Modern Definition of "Qualifying Child" Throughout the Internal Revenue Code*, *infra*.

18 American Rescue Plan Act of 2021, Pub. L. No. 117-2, § 9621, 135 Stat. 4, 152-153 (2021) (codified at IRC § 32(n)).

19 U.S. Bureau of Lab. Stat., Employment Projections: Table 3.1, Civilian labor Force By Age, Sex, Race, and Ethnicity (modified Aug. 29, 2024), https://www.bls.gov/emp/tables/civilian-labor-force-summary.htm. Note that the data include workers who are 16, 17, and 18 years old. This legislative recommendation would not apply to these individuals except for 18-year-olds who are qualified homeless and former foster youth.

20 We recognize an unintended consequence of including UC in earned income is that it may diminish a taxpayer's EITC claim, and in some instances, may make taxpayers ineligible to claim the EITC.

21 The National Taxpayer Advocate also recommends that Congress simplify and modernize the definition of "qualifying child" as used throughout the code. *See Adopt a Consistent and More Modern Definition of "Qualifying Child" Throughout the Internal Revenue Code*, *infra*.

- Expand the age eligibility for the EITC to individuals who have attained age 19 (age 18 in the case of qualified homeless or former foster youth and age 24 for specified students), with no upper age limit.[22]
- Amend IRC § 32(c)(2)(A)(i) to include UC as EITC-qualifying earned income.

22 For legislative language generally consistent with this recommendation, see Working Families Tax Relief Act of 2023 § 101(a), (b), 118th Cong. (2023). Other bills would allow the childless EITC for working individuals who are age 18 and older. *See, e.g.*, Lower Your Taxes Act, H.R. 5953 § (3)(e), 118th Cong. (2023); EITC Age Parity Act of 2023, H.R. 5689 § 2, 118th Cong. (2023); EITC Modernization Act, H.R. 5421 § 3(f), 118th Cong. (2023); Worker Relief and Credit Reform Act of 2023, H.R. 1468 § (2)(b), 118th Cong (2023). *See also* EITC for Older Workers Act of 2024, H.R. 9361 § 2, 118th Cong. (2024) (repealing the upper age limit).

Legislative Recommendation #52

Adopt a Consistent and More Modern Definition of "Qualifying Child" Throughout the Internal Revenue Code

SUMMARY

- *Problem:* Numerous provisions in the tax code use the term "qualifying child," but they contain several different definitions of the term. These inconsistent definitions are confusing to taxpayers. The different definitions make compliance difficult, causing some taxpayers to fail to claim tax benefits for which they qualify and other taxpayers to claim tax benefits for which they do not qualify, which subjects them to liability for additional tax, penalties, and interest. Furthermore, the relationship test embedded in the definitions has not been updated to reflect the rise of non-traditional families and childcare arrangements, preventing certain primary caregivers from receiving benefits.

- *Solution:* Adopt a consistent and more modern definition of the term "qualifying child" throughout the tax code by using a consistent age requirement, removing or revising the relationship test to expand eligibility to modern families, and revising the definition of a "qualifying relative" to allow a taxpayer to claim the qualifying child of another taxpayer who is entitled to claim the child but does not do so.

PRESENT LAW

IRC § 152(a) broadly defines a "dependent" as a qualifying child or a qualifying relative.[1] IRC § 152(c) defines the term "qualifying child." In general, to be a qualifying child under IRC § 152(c), an individual must: (1) be under age 19, or age 24 if a student, unless permanently and totally disabled; (2) be the taxpayer's child, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them; (3) live with the taxpayer for more than half the year; (4) not provide more than one-half of the individual's own support during the year; and (5) not file a joint return for the year.

IRC § 152(c) is meant to provide a uniform definition of a qualifying child for five tax benefits: head-of-household (HoH) filing status, the Child and Dependent Care Credit, the Child Tax Credit (CTC), the Earned Income Tax Credit (EITC), and the dependency exemption.[2] The definition also affects eligibility for other provisions like premature distributions from tax-favored accounts for medical and education expenses, dependent care assistance programs, and family member fringe benefits.[3]

The Working Families Tax Relief Act of 2004[4] added the uniform definition to the tax code. At that time, Congress concluded the use of multiple definitions contributed to a lack of clarity.[5] Despite these efforts, there are still parts of the tax code that deviate from the uniform definition. For example, while the uniform definition requires a qualifying child be under age 19 (or age 24 if a student), the CTC may only be claimed with respect to children under age 17.[6] Another example: The term "qualifying child" and the relationships

1 IRC § 152(a).
2 IRC §§ 2(b), 21, 24, 32, 151. The dependency exemption is paused through 2025. IRC § 151(d)(5).
3 IRC §§ 81, 129, 132.
4 Pub. L. No. 108-311, § 201, 118 Stat. 1166, 1169-1165 (2004).
5 Staff of J. Comm. on Tax'n, 109th Cong., Gen. Explanation of Tax Legis. Enacted in the 108th Cong. 124-125, JCS-5-05 (J. Comm. Print 2005), https://www.jct.gov/publications/2005/jcs-5-05/.
6 IRC §§ 24(c)(4), 152(c)(3).

described in IRC § 152(c)(2) encompass several types of familial relationships, including grandchildren, but in the case of a married taxpayer who is seeking to be treated as unmarried for purposes of claiming HoH filing status, only a son or daughter meets the definition of a qualifying child – grandchildren do not qualify.[7]

IRC § 152(d) defines the term "qualifying relative." Under IRC § 152(d)(1)(D), one criterion for being a qualifying relative of a taxpayer is that the individual "is not a qualifying child of such taxpayer or any other taxpayer…." This provision, as currently written, excludes children who could be claimed as qualifying children by another taxpayer but are not.

REASONS FOR CHANGE

Consistency Reduces Confusion and Eases Administration

The deviations from a uniform definition are needlessly confusing. Not surprisingly, many taxpayers do not understand the differences in requirements. They may assume that if a child is "qualifying" for purposes of one IRC provision, the child is qualifying for all IRC provisions. Conversely, they may assume that if a child is not qualifying for purposes of one IRC provision, the child is not a qualifying child for any IRC provision.[8] This confusion can result in taxpayers filing inaccurate tax returns, which may lead to audits and additional tax liabilities, plus penalties and interest charges. It can also result in taxpayers failing to claim benefits to which they are entitled. For example, in tax year 2021, about 14 percent of taxpayers with children who are eligible to receive EITC benefits did not claim them.[9]

Confusion also increases the administrative burden on the IRS, as it must program its return processing systems using different definitions for different provisions, it must program its audit selection models to distinguish among conflicting definitions, and it must devote audit and collection resources to reporting inaccuracies that exist solely because taxpayers and even some tax preparers confuse the various definitions when filling out tax returns.

The Relationship Test Prevents Primary Caregivers From Receiving Certain Tax Benefits

The uniform definition and other eligibility rules for family-focused tax benefits, such as the EITC and CTC, were written when two-parent households predominated. Living arrangements have since evolved. Blended families, multigenerational family arrangements, divorce, and cohabitation have become more common.[10] Childcare arrangements have become complex as more children split their time between different households, and four percent of children live with or are supported by non-parent relatives and others.[11]

When children are raised or informally fostered by nonqualified relatives or family friends, benefits like the EITC and CTC cannot be properly claimed. Taxpayers can only receive the child-related portion of the EITC

7 IRC §§ 152, 7703(b).

8 *See, e.g.*, Treasury Inspector General for Tax Administration, Ref. No. 2021-40-070, *Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation* 6-7 (2021), https://www.tigta.gov/reports/audit/addressing-complex-and-inconsistent-earned-income-tax-credit-and-additional-child-tax.

9 IRS/Census Exact Match, Project 6000463. Release authorization CBDRB-FY24-CES004-016, CBDRB-FY24-CES026-014, CBDRB-FY24-CES004-018.

10 *See, e.g.*, Lydia R. Anderson et al., U.S. Census Bureau, P70-174, Current Population Reports, Living Arrangements of Children: 2019 (Feb. 2022), https://www.census.gov/content/dam/Census/library/publications/2022/demo/p70-174.pdf.

11 *See, e.g.*, Jacob Goldin & Ariel Jurow Kleiman, *Whose Child Is This? Improving Child-Claiming Rules in Safety-Net Programs*, 131 Yale L.J. 1719 (2022), https://www.yalelawjournal.org/article/whose-child-is-this; Elaine Maag et al., Urban Inst., Increasing Family Complexity and Volatility: The difficulty in Determining Child Tax Benefits 11 (2016), https://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits; Lydia R. Anderson et al., U.S. Census Bureau, P70-174, Current Population Reports, Living Arrangements of Children: 2019, at 3 tbl.1, (Feb. 2022), https://www.census.gov/content/dam/Census/library/publications/2022/demo/p70-174.pdf; U.S. Census Bureau, *Historical Living Arrangements of Children*, Fig. CH-1 (Nov. 2023), https://www.census.gov/data/tables/time-series/demo/families/children.html.

and the CTC when they have a qualifying child, not a qualifying relative.[12] The IRC § 152(c)(2) relationship test for a qualifying child restricts eligibility to only a few close relatives.[13] This test mainly excludes children who live in low-income households.[14] It is estimated that the relationship test excludes two million children for purposes of some CTC benefits.[15] A child who does not live with a sufficiently close relative cannot be claimed by anyone.[16] Similarly, the relationship rules where a taxpayer is seeking to be treated as unmarried for purposes of HoH filing status prevent the taxpayer from claiming grandchildren.[17]

Congress can address these shortcomings by modernizing the uniform definition of a qualifying child, as the current definition often no longer reflects real-life living arrangements. The definition should be amended to encompass more types of families. The overly restrictive relationship test of IRC § 152(c)(2) should be expanded to include additional categories of relatives or replaced with a holistic primary caregiver standard.[18] The residency test and other requirements should remain in place to ensure the tax benefits are going to taxpayers providing care to children in their household.[19]

To allow heads of non-traditional families to claim children they care for as dependents, another amendment to the current IRC § 152 rules would make a significant difference – adding the words "claimed as" to IRC § 152(d)(1)(D), so the term "qualifying relative" means an individual who is not *claimed as* a qualifying child of such taxpayer or of any other taxpayer for any taxable year in the calendar year in which such taxable year begins. That language would also conform to the language used in IRC § 152(c)(4)(C) that allows a taxpayer other than a parent to claim a qualifying child. Under that provision, if the parents may claim a qualifying child but neither parent does so, the child may be claimed as the qualifying child of another taxpayer if the adjusted gross income of that taxpayer is higher than the highest adjusted gross income of either parent.[20]

RECOMMENDATIONS

- Adopt a consistent and more modern definition of the term "qualifying child" throughout the IRC.
- Use a consistent age when defining a "qualifying child."
- Modernize the definition of a qualifying child in IRC § 152(c) to reflect evolving family units either by expanding the relationship test described in IRC § 152(c)(1)(A) and (2) to include additional categories of relatives or by replacing the relationship test of IRC § 152(c)(1)(A) and (2) with a primary caregiver standard.
- Amend IRC § 152(d)(1)(D) to provide that the term "qualifying relative" means an individual "who is not claimed as a qualifying child of such taxpayer or of any other taxpayer for any taxable year in the calendar year in which such taxable year begins."

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12 IRC §§ 24, 32, 152.

13 IRC § 152(c).

14 *See* Jacob Goldin & Katherine Michelmore, *Who Benefits from the Child Tax Credit?* (Nat'l Bureau of Econ. Rsch., Working Paper No. 27940, 2021), http://www.nber.org/papers/w27940.

15 *Id.* at 19, 29 tbl.3.

16 IRC §§ 24(c), 152(c).

17 IRC §§ 2(b), 152(f)(1), 7703(b).

18 Relevant considerations should include which adult performs caregiving and makes caregiving decisions for the child, including factors like who prepares meals, who transports the child to school, and who makes medical appointments for the child. For a more detailed discussion on modernizing the definition of a qualifying child, see National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress vol. 3, at 17 (*Earned Income Tax Credit: Making the EITC Work for Taxpayers and the Government*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/JRC20_Volume3.pdf; *see also* Ariel Jurow Kleiman, *Revolutionizing Redistribution: Tax Credits and the American Rescue Plan*, 131 Yale L.J. Forum 535, 555-556 (2021), https://www.yalelawjournal.org/forum/revolutionizing-redistribution-tax-credits-and-the-american-rescue-plan.

19 *See* IRC § 152(c)(1)(B)-(E).

20 *See* IRC § 152(c)(4)(C).

Legislative Recommendation #53

Permanently Give Taxpayers Affected by Federally Declared Disasters the Option of Using Prior Year Earned Income to Claim the Earned Income Tax Credit (EITC)

SUMMARY

- *Problem:* A low-income worker who loses their job due to a federally declared disaster may suffer a double financial hit – loss of earned income and loss of Earned Income Tax Credit (EITC) benefits. On several occasions, Congress has mitigated this impact by allowing taxpayers affected by federally declared disasters to claim EITC benefits based on their prior year's earned income. But on other occasions, similarly affected taxpayers did not receive this relief.

- *Solution:* Establish a general rule giving taxpayers in federally declared disaster areas the option of claiming EITC benefits based on their prior year's earned income.

PRESENT LAW

The EITC is a refundable credit for low- and moderate-income working families. Eligibility for the EITC and the amount of EITC to which a taxpayer is entitled are based on several factors, including the taxpayer's earned income, filing status, and number of qualifying children, if any.[1]

IRC § 165(i)(5) defines a "federally declared disaster" as any disaster determined by the President to warrant federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, and it defines a "disaster area" as any area so determined to warrant federal assistance.

On numerous occasions when the President has declared a disaster, Congress has passed legislation to give affected taxpayers who earn less income in the disaster year than the prior year the option of using their prior year's income to claim EITC benefits. This provision is referred to as the "EITC lookback rule." Most recently, Congress authorized the EITC lookback rule for tax years 2020 and 2021 to provide relief from the COVID-19 pandemic.[2]

REASONS FOR CHANGE

In general, the EITC is designed to incentivize work, and its benefits are only available to individuals who have earned income. During major disasters like a pandemic, a hurricane, or a wildfire, many employed taxpayers experience an unexpected disruption in work and a loss of earned income. Where affected taxpayers previously had earned income levels that qualified them for EITC benefits, they may suffer a double financial hit: (i) they may lose the income earned from their jobs and (ii) they may lose their EITC benefits because they are no longer earning income.

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1 IRC § 32.

2 *See*, *e.g.*, American Rescue Plan Act, Pub. L. No. 117-2, § 9626, 135 Stat. 4, 157 (2021); Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, Div. EE, Title II, § 211, 134 Stat. 1181, 3066-3067 (2020); Disaster Tax Relief and Airport and Airway Extension Act of 2017, Pub. L. No. 115-63, § 504, 131 Stat. 1168, 1183 (2017); Heartland Disaster Tax Relief of 2008, Pub. L. No. 110-343, Div. C, Title VII, Subtitle A, § 701, 122 Stat. 3765, 3912 (2008); Katrina Emergency Tax Relief Act of 2005, Pub. L. No. 109-73, Title IV, § 406, 119 Stat. 2016, 2028 (2005).

The EITC lookback rule is designed to provide relief to taxpayers in this circumstance. To illustrate, assume a taxpayer who is a parent and was consistently employed for several years was laid off when the COVID-19 pandemic struck in early 2020. As a result, the taxpayer did not have sufficient 2020 earned income to qualify for significant EITC benefits but earned sufficient income in the prior year to qualify. The EITC lookback rule provided relief by allowing the taxpayer to qualify for EITC benefits based on their 2019 income.

To date, Congress has authorized use of the EITC lookback rule on a disaster-by-disaster basis. This one-off approach means similarly situated taxpayers are treated differently, where taxpayers affected by some disasters receive relief while taxpayers facing identical challenges from other disasters do not. To ensure a fair and just tax system for all taxpayers affected by federally declared disasters, the National Taxpayer Advocate recommends that Congress amend IRC § 32 to permanently provide the EITC lookback option for all taxpayers who are affected by a federally declared disaster as defined in IRC § 165(i)(5).

RECOMMENDATION

- Amend IRC § 32 to permanently allow taxpayers who are affected by a federally declared disaster as defined by IRC § 165(i)(5) to elect to use their prior year's earned income to calculate and claim the EITC.[3]

3 For legislative language generally consistent with this recommendation, see Tax Fairness for Disaster Victims Act, H.R. 2619, 118th Cong. § 2 (2023).

Legislative Recommendation #54

Allow the Limitation on Theft Loss Deductions in the Tax Cuts and Jobs Act to Expire So Scam Victims Are Not Taxed on Amounts Stolen From Them

SUMMARY

- *Problem:* The tax code historically has allowed individual taxpayers to deduct theft losses, but for tax years 2018 through 2025 the code has sharply restricted the availability of this deduction. Together with timing constraints on deductions and refund claims, this restriction generally prevents scam victims from offsetting their losses.
- *Solution:* Allow the current theft loss restriction to expire, thereby restoring the pre-2018 rules, and allow taxpayers to claim a theft loss deduction in the year of the related income event by filing an amended return even if they discovered the theft after the refund limitations period.

PRESENT LAW

IRC § 165(a) generally authorizes taxpayers to deduct "any loss sustained during the taxable year and not compensated for by insurance or otherwise." For tax years 2018 through 2025, IRC § 165(h)(5) provides that an individual taxpayer may only claim a casualty and theft loss deduction to the extent the loss is attributable to a federally declared disaster.[1]

Under IRC § 165(c), the limitation of IRC § 165(h)(5) does not apply where an individual taxpayer incurs the loss in a trade or business or in any transaction entered into for profit.[2]

IRC § 165(e) provides that a taxpayer must deduct a theft loss in the year in which the taxpayer discovers the theft.

IRC § 72(t) imposes a ten percent additional tax on early distributions from qualified retirement accounts made before the taxpayer reaches age 59½, with enumerated exceptions.[3]

REASONS FOR CHANGE

Before the Tax Cuts and Jobs Act (TCJA),[4] IRC § 165 allowed individual taxpayers who are victims of theft to deduct their losses from taxable income. The TCJA significantly narrowed this deduction. As a result, many scam victims now face tax bills on money they lost to fraudsters.

While the theft loss deduction is still available for businesses and for individuals who incur losses in transactions entered into for profit under IRC § 165(c), most scam victims do not fall into these categories.

1 IRC § 165 losses are colloquially referred to as "casualty and theft" losses. Casualty losses include losses attributable to federally declared disasters, which have generally remained deductible under the Tax Cuts and Jobs Act (TCJA). Theft losses incurred by individuals, however, generally may not be deducted under the TCJA. *See* Pub. L. No. 11597, § 11044, 131 Stat. 2054, 2087 (2017).

2 IRC § 165(c)(1) addresses losses incurred in a trade or business, while IRC § 165(c)(2) addresses losses incurred in any transaction entered into for profit (although not connected with a trade or business).

3 The ten percent amount is legally an additional tax, although it is often referred to as a ten percent "penalty." Exceptions are enumerated in IRC § 72(t)(2).

4 Pub. L. No. 115-97, § 11044, 131 Stat. 2054, 2087 (2017).

The IRS previously provided relief for Ponzi scheme victims, determining such false investments were entered into for profit,[5] but currently there is no similar protection for victims of other scams.

> *Example:* A taxpayer, scammed into withdrawing retirement funds, must pay taxes on the withdrawal, plus a ten percent additional tax if they are not yet 59½ years old.[6] This is the case even though the scammer absconded with the funds and the taxpayer never benefitted from the money withdrawn.

Whether a scam victim can deduct a loss like this often depends on proving a profit motive.[7] This may be plausible for investment scams, but it is nearly impossible for romance, technical support, or scare tactic scams.[8]

Even when a deduction is permitted, existing statute of limitation periods can prevent victims from claiming refunds if they discover the scam too late.[9] In addition, because current law requires the taxpayer to claim the deduction in the year the theft was discovered (not in the year the taxpayer lost the money), a taxpayer who is still within the statute of limitations period for a refund might not have enough income in the later year to deduct the loss fully.[10] This means victims might not be able to deduct all of their losses against the amount stolen from them.[11]

RECOMMENDATIONS

- Allow the current provisions of IRC § 165(h)(5) to expire, thereby reinstating the pre-TCJA language so its availability is not limited to losses incurred in federally declared disaster areas.[12]
- Amend the current IRC § 165(e) to enable scam victims to deduct a loss in the same year as any associated income inclusion event.[13]
- Amend IRC § 6511 to extend the limitations period for refund claims related to newly discovered theft losses due to scams.
- Amend IRC § 72(t) to create an exception to the ten percent additional tax on early distributions from qualified plans (*e.g.,* IRC § 401(k), IRA, or other tax-deferred accounts) that were withdrawn because of a scam.

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5 Rev. Rul. 2009-9, 2009-14 I.R.B 735; Rev. Proc. 2009-20, 2009-14 I.R.B. 749, *as modified by* Rev. Proc. 2011-58, 2011-50 I.R.B 849. These rulings were issued to provide clarity to victims of a scheme famously perpetrated by Bernard Madoff.

6 IRC § 72(t)(1).

7 For factors to consider in determining whether a taxpayer entered into a transaction for profit, see Treas. Reg. § 1.183-2.

8 For a discussion of tax-related scams, see National Taxpayer Advocate 2024 Annual Report to Congress, https://www.taxpayeradvocate.irs.gov/AnnualReport2024.

9 IRC § 6511.

10 IRC § 165(e).

11 Consider an example that illustrates how losses may be limited. Assume a taxpayer with a fixed annual income of $50,000 is scammed out of $100,000 from their IRC § 401(k) account in Year One, creating total income in that year of $150,000. In Year Three, the taxpayer discovers the scam. Under current law, the taxpayer cannot deduct the $100,000 loss against the Year One income of $150,000. Instead, the taxpayer must claim the deduction in Year Three against their fixed income of $50,000. This means there may not be enough income for the taxpayer to net out the $100,000 theft loss.

12 Congress could choose to make this change retroactive to provide relief to recent scam victims.

13 Congress could give taxpayers the option to claim the loss in the year a statutory change is enacted.

Legislative Recommendation #55

Amend the Lookback Period for Allowing Tax Credits or Refunds to Include the Period of Any Postponement or Additional or Disregarded Time for Timely Filing a Tax Return

SUMMARY

- *Problem:* Taxpayers who file their tax returns by the April 15 filing deadline ordinarily have until April 15 three years later to file a claim for credit or refund of any overpayments of tax. When a filing deadline is postponed due to a federally declared disaster or similar reason, however, the three-year "lookback period" for *paying* refunds is not correspondingly extended. Consequently, some taxpayers who take advantage of postponed filing deadlines cannot obtain refunds even if they timely file their refund claims.

- *Solution:* When a filing deadline is postponed, extend the three-year lookback period in which the IRS may allow claims for credit or refund by the same amount of time.

PRESENT LAW

IRC § 6511(a) provides that taxpayers who believe they have overpaid their tax generally may file a claim for credit or refund with the IRS by the later of:

1. Three years from the date the return was filed; or
2. Two years from the date the tax was paid.

IRC § 6511(b) places limits on the amount the IRS may credit or refund by using a two-year or three-year lookback period:

1. Taxpayers who file claims for credit or refund within three years from the date the original return was filed will have their credits or refunds limited to the amounts paid within the three-year period before the filing of the claim, *plus the period of any extension of time for filing the original return* (the "three-year lookback period"). *See* IRC § 6511(b)(2)(A).
2. Taxpayers who do not file claims for credit or refund within three years from the date the original return was filed will have their credits or refunds limited to the amounts paid within the two-year period immediately preceding the filing of the claim. *See* IRC § 6511(b)(2)(B).

For calendar year taxpayers, IRC § 6513(b) provides that any tax deducted and withheld on wages and any amounts paid as estimated tax are deemed paid on April 15 in the year following the close of the taxable year for which the paid tax is allowable as a credit.

There are certain circumstances in which filing deadlines may be postponed. For example, under IRC § 7508A, when the Secretary determines that a taxpayer has been affected by a federally declared disaster, the Secretary is authorized to disregard for up to one year certain acts a taxpayer is required to undertake under the IRC, including the filing of a tax return.[1] The time that is disregarded in this context has been described as

1 IRC § 7508A(a)(1) also authorizes the Secretary to disregard a period of up to one year when determining whether certain IRS acts are timely.

a "postponement."[2] The Secretary exercises this authority regularly.[3] For example, the Secretary exercised this authority during the COVID-19 pandemic by disregarding the period from April 15 to July 15 in 2020, and disregarding the period from April 15 to May 17 in 2021 for purposes of timely filing an individual income tax return.[4]

REASONS FOR CHANGE

In most circumstances, the deadline for taxpayers to file claims for refund or credit under IRC § 6511(a) and the time in which the IRS may issue a refund or credit under IRC § 6511(b) seamlessly align. That is true both when a taxpayer files a return by the regular April 15 filing deadline and when a taxpayer requests an extension of time and files a return by October 15. When a return filing deadline is postponed under IRC § 7508A, however, the three-year lookback period for the IRS to issue a refund or credit is not automatically extended. As a result, a taxpayer who takes advantage of a postponed filing deadline beyond April 15 may not receive a refund or credit if they wait three years to file a claim.

> *Example:* In 2019, a taxpayer had income tax withheld from his paycheck every two weeks. The taxpayer filed his 2019 return on the *postponed* filing deadline of July 15, 2020. The taxpayer's 2019 tax liability was fully paid through withholding, which was deemed paid on April 15, 2020. Based on the return filing date of July 15, 2020, the taxpayer filed a claim for refund on July 14, 2023. Under IRC § 6511(a), the claim for refund was timely, as it was filed within three years from the return filing date. Under the three-year lookback period of IRC § 6511(b), however, the amount of the taxpayer's refund was limited to payments made in the three years prior to filing the claim (*i.e.*, payments made on or after July 14, 2020). The withholding deemed paid on April 15, 2020, fell outside that period,[5] so the refund amount was limited to $0, effectively denying the taxpayer any refund.
>
> By contrast, if the taxpayer had requested a filing extension until October 15, 2020, the taxpayer would have had until October 16, 2023, (because October 15, 2023, was a Sunday)[6] to file a claim and receive a full refund, because the lookback period of IRC § 6511(b)(2)(A) includes the extension period.

The IRS remedied this problem for the tax years for which filing deadlines were postponed during the COVID-19 pandemic. The IRS issued Notice 2023-21,[7] under its authority in IRC § 7508A(a), to disregard the period of postponement when determining the beginning of the lookback period for taxpayers who timely filed 2019 or 2020 tax returns pursuant to the postponements. Thus, under this notice, taxpayers were able to file claims for credit or refund within three years of the postponed return due dates without having their credits or refunds barred by the three-year lookback period.

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2 *See* Treas. Reg. § 301.7508A-1(d)(3).

3 *See* IRS, Tax Relief in Disaster Situations (Sept. 13, 2024), https://www.irs.gov/newsroom/tax-relief-in-disaster-situations.

4 *See* IRS Notice 2020-23, 2020-18 I.R.B. 742, Update to Notice 2020-18, Additional Relief for Taxpayers Affected by Ongoing Coronavirus Disease 2019 Pandemic, https://www.irs.gov/pub/irs-drop/n-20-23.pdf; IRS Notice 2021-21, 2021-15 I.R.B. 986, Relief for Form 1040 Filers Affected By Ongoing Coronavirus Disease 2019 Pandemic, https://www.irs.gov/pub/irs-drop/n-21-21.pdf. These notices did not affect the date on which any withheld tax or estimated tax for 2019 or 2020 was deemed paid. *See* Treas. Reg. § 301.7508A-1(b)(4) ("To the extent that other statutes may rely on the date a return is due to be filed, the postponement period will not change the due date of the return"). Any withheld tax or estimated tax for 2019 was deemed paid on April 15, 2020, for calendar year taxpayers. Similarly, any withheld or estimated tax for 2020 was deemed paid on April 15, 2021, for calendar year taxpayers.

5 This would be the same for any estimated tax payments.

6 *See* IRC § 7503 (when the last day for filing falls on a Saturday, Sunday, or legal holiday, the act will be timely if performed on the next business day). *See also* Rev. Rul. 2003-41, 2003-17 C.B. 814 (concluding that when a return is filed on the first business day after a weekend or legal holiday, the lookback period is adjusted accordingly), https://www.irs.gov/pub/irs-irbs/irb03-17.pdf.

7 2023-11 I.R.B. 563, Lookback Periods for Claims for Credit or Refund for Returns with Due Dates Postponed by Notice 2020-23 or Notice 2021-21, https://www.irs.gov/irb/2023-11_IRB.

Notice 2023-21, however, only fixed the problem for claims for credit or refund for tax years 2019 and 2020 with respect to the COVID-19 postponement. Thus, the outcome in the above example generally persists for taxpayers when the IRS postpones return filing deadlines due to federally declared disasters. We do not believe such an outcome was intended. Because of the large number of federally declared disasters for which the IRS grants relief each year and the millions of taxpayers affected, we recommend that Congress provide a permanent solution to this problem.[8]

RECOMMENDATION

- Amend IRC § 6511(b)(2)(A) to provide that when any postponement or addition or disregarding of time is granted pursuant to the IRC for purposes of timely filing, the limit on the amount of a credit or refund will be the amounts paid in the three-year period preceding the filing of a claim for credit or refund, *plus any period of extension, postponement, or additional or disregarded time for timely filing the related return.*

8 Other contexts where this could occur include: (1) when additional time is provided under IRC § 7503 if a due date falls on a Saturday, Sunday, or legal holiday and (2) when time is disregarded under IRC § 7508 while an individual is serving in a combat zone or contingency operation.

Legislative Recommendation #56

Protect Taxpayers in Federally Declared Disaster Areas Who Receive Filing and Payment Relief From Inaccurate and Confusing Collection Notices

SUMMARY

- *Problem:* When the IRS postpones a filing and payment deadline due to a federally declared disaster, some taxpayers with balances due file their returns before the postponed deadline but wait until the postponed deadline to make payment. That is permissible, yet the law generally requires the IRS to mail a "notice and demand" for payment within 60 days of an assessment, which commonly occurs after the taxpayer files their return. These notices include language about interest and penalties accruing before the postponed due date, causing needless confusion and worry for taxpayers and needless work for the IRS. In 2023, over a million California taxpayers received these confusing notices, as did taxpayers in Alabama, Arkansas, Florida, Georgia, Indiana, Mississippi, and Tennessee.

- *Solution:* When the IRS postpones a filing and payment deadline, tie the deadline for mailing a notice and demand for payment to the postponed filing deadline if the return is filed prior to the postponed date.

PRESENT LAW

IRC § 7508A provides that when the Secretary determines a taxpayer has been affected by a federally declared disaster, a significant fire, or a terroristic or military action, the Secretary is authorized to "disregard" for up to one year certain acts the taxpayer and the government are required to undertake under the internal revenue laws, including the filing of a tax return and the payment of tax.[1] The time disregarded in this context has been described as a "postponement."[2]

IRC § 6303(a) requires the IRS to issue a notice and demand for payment within 60 days of assessment. An assessment generally occurs after a taxpayer files a return showing a tax liability (*i.e.,* the taxpayer self-reports the tax, also known as a "self-assessment"). Under IRC § 6303(b), if an assessment occurs before the last date prescribed for payment of tax, no notice and demand for payment is required until after the last date "prescribed" for payment of tax.[3]

REASONS FOR CHANGE

A period of postponement under IRC § 7508A does not change the due date of the return.[4] Thus, a glitch in the rules arises because a "postponed" payment deadline does not change the "prescribed" payment deadline. It merely allows the IRS to disregard a period of up to one year for performance of the tax-related act.[5] Because the prescribed due date for payment does not change, IRC § 6303 requires the IRS to issue a notice and demand for payment within 60 days of assessment.

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1 IRC § 7508A(a) (citing IRC § 7508(a)(1)).
2 *See* Treas. Reg. § 301.7508A-1(d)(3).
3 *See also* IRC § 6151.
4 Treas. Reg. § 301.7508A-1(b)(4).
5 IRC § 7508A(a) (citing IRC § 7508(a)(1)); Treas. Reg. § 301.7508A-1(b)(4).

In 2023, the IRS postponed certain filing and payment deadlines for taxpayers affected by severe weather in almost all of California.[6] Some of these taxpayers filed their returns with a balance due before the postponed deadline but held off on making payments until the postponed deadline.

> *Example:* The regular filing deadline of April 15 is postponed until November 15. A taxpayer files a balance due return on June 1 and plans to make payment on the postponed filing deadline of November 15. The assessment of tax occurs on June 1 (by reason of the self-assessed tax on the filed return), and the IRS issues a notice and demand for payment within 60 days (*i.e.*, by July 31). The notice informs the taxpayer that interest and penalties will accrue after the due date reflected on the front page of the notice. The taxpayer is concerned that the accountant's advice about waiting to make a payment until the postponed due date was incorrect and is worried he or she may face IRS collection action. As a result, the taxpayer may pay the tax earlier than legally required (November 15) or may seek additional advice from the accountant and incur additional fees.

The IRS sent over a million of these notice and demand letters to taxpayers in California covered by a disaster relief declaration.[7] It also sent these notices to taxpayers in Alabama, Arkansas, Florida, Georgia, Indiana, Mississippi, and Tennessee.[8] The IRS included a short paragraph on the back of page four of the notice explaining that the taxpayer may qualify for disaster relief. After receiving complaints from affected taxpayers and tax professionals, the IRS later sent out updated notices to clarify that taxpayers covered by disaster declarations did not have to pay before the postponed due date.[9] But the IRS continued to send out notice and demand letters to taxpayers whose returns showed a balance due because it believes the notice is legally required to protect its ability to later collect any unpaid tax.[10]

Under IRC § 7508A, the Secretary has the legal authority to postpone issuing a notice and demand for payment, but the Secretary has rarely done so.[11] We urge the Secretary to routinely postpone notices and demands for payment when postponing filing and payment deadlines. However, because of the large number of federally declared disasters for which the IRS grants relief each year and the millions of affected taxpayers,[12]

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6 *See* IRS, IRS Announces Tax Relief for Victims of Severe Winter Storms, Flooding, Landslides, and Mudslides in California, https://www.irs.gov/newsroom/irs-announces-tax-relief-for-victims-of-severe-winter-storms-flooding-landslides-and-mudslides-in-california (last visited Oct. 8, 2024). Seven other states (Alabama, Arkansas, Florida, Georgia, Indiana, Mississippi, and Tennessee) faced a similar issue with incorrect notice and demand letters. *See* Erin M. Collins, Disaster Relief: What the IRS giveth, the IRS taketh away. Or so it seems for disaster relief taxpayers until you get to page 4 of the collection notice (Part One), National Taxpayer Advocate Blog (July 11, 2023), https://www.taxpayeradvocate.irs.gov/news/nta-blog-cp-14-collection-notice-part-one; IRS News Release, IR-2023-121, IRS Sends Special Mailing to Taxpayers in Certain Disaster Areas (June 28, 2023), https://www.irs.gov/newsroom/irs-sends-special-mailing-to-taxpayers-in-certain-disaster-areas.

7 Natalie Campisi, *IRS Collection Notices Go Out To 1 Million Taxpayers By Mistake; Disaster-Related Extensions Still Apply*, Forbes, July 14, 2023, https://www.forbes.com/advisor/taxes/california-disaster-tax-relief.

8 *See* Erin M. Collins, Disaster Relief: What the IRS giveth, the IRS taketh away. Or so it seems for disaster relief taxpayers until you get to page 4 of the collection notice (Part One), National Taxpayer Advocate Blog (July 11, 2023), https://www.taxpayeradvocate.irs.gov/news/nta-blog-cp-14-collection-notice-part-one.

9 *See* Erin M. Collins, Disaster Relief: What the IRS giveth, the IRS taketh away. Or so it seems for disaster relief taxpayers until you get to page 4 of the collection notice. (Part One), National Taxpayer Advocate Blog (July 11, 2023), https://www.taxpayeradvocate.irs.gov/news/nta-blog-cp-14-collection-notice-part-one; Erin M. Collins, Disaster Relief: What the IRS giveth, the IRS taketh away. Or so it seems for disaster relief taxpayers until you get to page 4 of the collection notice. (Part Two), National Taxpayer Advocate Blog (July 12, 2023), https://www.taxpayeradvocate.irs.gov/news/nta-blog-cp-14-collection-notice-part-two/. *See also* IRS, IRS Statement on California Mailing of Balance Due Notices (June 30, 2023), https://www.irs.gov/newsroom/irs-statement-on-california-mailing-of-balance-due-notices.

10 In 2024, the IRS introduced a disaster coversheet to accompany the notice and demand letters. The package now includes the notice and demand with the non-postponed due date and the coversheet with the postponed due date. Although this added coversheet is an improvement, the conflicting information still creates the risk of taxpayer confusion.

11 Treas. Reg. § 301.7508A-1(c)(2)(ii). *See, e.g.*, IRS Notice 2023-71, 2023-44 I.R.B. 1191, Relief for Taxpayers Affected by the Terroristic Action in the State of Israel, https://www.irs.gov/pub/irs-drop/n-23-71.pdf; IRS Notice 2020-23, 2020-18 I.R.B. 742, Update to Notice 2020-18, Additional Relief for Taxpayers Affected by Ongoing Coronavirus Disease 2019 Pandemic, https://www.irs.gov/pub/irs-drop/n-20-23.pdf.

12 *See* IRS, Tax Relief in Disaster Situations, https://www.irs.gov/newsroom/tax-relief-in-disaster-situations (last visited Oct. 8, 2024).

we recommend that Congress pass legislation to provide a permanent solution to this problem so that case-by-case exceptions are not required. The proposed recommendation would keep the IRS from mailing notices that lead to taxpayer confusion and anxiety.

RECOMMENDATION

- Amend IRC § 6303(b) to include postponement periods when determining the last date prescribed for payment of tax.

Legislative Recommendation #57

Allow Taxpayers in Limited Circumstances to Claim the Child Tax Credit With Respect to Children Who Do Not Have Social Security Numbers But Otherwise Qualify for the Credit

SUMMARY

- *Problem:* In 2017, Congress enacted legislation that prohibits taxpayers from claiming a child for purposes of the child tax credit (CTC) if the child does not have a Social Security number (SSN). This restriction was not intended to exclude children who are U.S. citizens. However, there are at least three categories of children who are U.S. citizens but do not have SSNs. The change in law has had the unintended effect of preventing families from receiving CTC benefits with respect to these children.

- *Solution:* Allow children who are U.S. citizens and do not have SSNs to be claimed for purposes of the CTC in the limited circumstances described below, provided they meet all other eligibility requirements.

PRESENT LAW

The Tax Cuts and Jobs Act (TCJA) amended IRC § 24(h)(7) to require a taxpayer claiming the CTC to provide an SSN valid for employment for a qualifying child.[1]

REASONS FOR CHANGE

The requirement under IRC § 24(h)(7) that a qualifying child claimed for the CTC have an SSN valid for employment was intended to prevent a taxpayer whose child is not a U.S. citizen or is not otherwise eligible for an SSN from receiving the CTC. However, the provision is having the unintended effect of disqualifying several taxpayer populations whose dependents are U.S. citizens who lack SSNs due to unique circumstances but otherwise meet the requirements for the credit. Taxpayer populations whose children are U.S. citizens but do not have SSNs include the following:

- Taxpayers who do not apply for SSNs due to deeply held religious beliefs, most notably the Amish;[2]
- Taxpayers whose adopted children have not yet received SSNs; and
- Taxpayers who are unable to obtain an SSN for a qualifying child because the child was born and died in the same or consecutive tax years (*i.e.*, before the Social Security Administration issued an SSN for the child).

1 TCJA, Pub. L. No. 115-97, § 11022(a), 131 Stat. 2054, 2073-2074 (2017) (codified at IRC § 24(h)(7)).

2 IRC § 1402(g) provides an exemption from the requirement to pay self-employment tax for an individual who "is a member of a recognized religious sect or division thereof and is an adherent of established religious tenets or teachings of such sect or division by reason of which he is conscientiously opposed to acceptance" of Social Security benefits, Medicare, or other insurance plans. Because SSNs are used to keep track of Social Security taxes and benefits, some of these individuals are also conscientiously opposed to obtaining SSNs. To claim the exemption, an individual must apply on IRS Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits. For purposes of the Child Tax Credit, taxpayers whose qualifying children did not have an SSN or other TIN due to the taxpayers' deeply held religious beliefs were allowed the credit, prior to enactment of the TCJA, if the taxpayers indicated on their tax returns that they have an approved Form 4029 establishing that they had met the requirements under IRC § 1402(g).

Taxpayers who do not apply for SSNs due to deeply held religious beliefs. Prior to the TCJA amendment, IRC § 24 only required a taxpayer claiming a child for purposes of the CTC to provide a taxpayer identification number (TIN) for the child.[3] The TIN did not have to be an SSN. In addition, the IRS provided administrative relief to allow the credit to a taxpayer without a TIN for a qualifying child due to the taxpayer's deeply held religious beliefs. The fact that taxpayers with religious-based reasons for not obtaining SSNs for their children are now barred by the TCJA from receiving the CTC not only denies them a valuable tax benefit but may also constitute a violation of the Religious Freedom Restoration Act.[4]

Taxpayers whose adopted children have not yet received SSNs. The CTC language prior to the TCJA change permitted the IRS to allow the credit for taxpayers whose children had Adoption Taxpayer Identification Numbers (ATINs), which are TINs issued by the IRS for use while waiting to receive SSNs for adopted children. Since the passage of the TCJA, the IRS is no longer providing administrative relief to allow the CTC with respect to children with ATINs.

Taxpayers who are unable to obtain an SSN for a qualifying child because the child was born and died in the same or consecutive tax years. The TCJA requires taxpayers to provide an SSN for a qualifying child to claim the CTC with respect to children who are born and die in the same or consecutive tax years, but the IRS currently is making an administrative exception to this requirement. While we are pleased this category of taxpayers is receiving relief, it is unclear on what basis the IRS has the legal authority to create an administrative exception to the statutory SSN requirement for this category of affected taxpayers but not for others.

The National Taxpayer Advocate believes these taxpayer populations are being treated unjustly because the TCJA language did not provide an exception to the SSN requirement for qualifying children in these specific groups, thereby denying them the CTC to which they are otherwise entitled. Moreover, the IRS is now applying the law inconsistently by allowing an exception for children who were born and died in the same or consecutive tax years while not allowing an exception for similar categories of children – namely, children who do not have an SSN due to their parents' deeply held religious beliefs and children who were adopted and have an ATIN for the year for which the tax credit is being claimed.

RECOMMENDATION

- Amend IRC § 24(h)(7) to allow a taxpayer to claim the CTC with respect to a qualifying child without an SSN if the taxpayer meets all other eligibility requirements for the credit and if the taxpayer:
    - Has a sincere and deeply held religious belief that prohibits them from obtaining an SSN;
    - Adopted a child (or has a child placed with the taxpayer for legal adoption by an authorized placement agency) and provides an ATIN for the child; or
    - Had a child who was born and who died in the same or consecutive tax years.

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3 A TIN is an identification number used by the IRS in administering the tax laws. It includes an SSN but also includes an Individual Taxpayer Identification Number (ITIN), an Adoption Taxpayer Identification Number (ATIN), and other identifying numbers.

4 *See The Tax Filing Season: Hearing Before the H. Subcomm. on Gov't Oversight of the H. Comm. on Ways and Means*, 116th Cong. 22-27 (2019) (testimony of Nina E. Olson, then the National Taxpayer Advocate); National Taxpayer Advocate Fiscal Year 2020 Objectives Report to Congress 48 (Area of Focus: *TAS Will Urge the IRS to Reconsider Its Position on the Application of the Religious Freedom Restoration Act to the Social Security Requirement Under IRC § 24(h)(7), Which Has the Effect of Denying Child Tax Credit Benefits to the Amish and Certain Other Religious Groups*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/JRC20_Volume1_AOF_02.pdf.

Legislative Recommendation #58

Clarify Whether Dependents Are Required to Have Taxpayer Identification Numbers for Purposes of the Credit for Other Dependents

SUMMARY

- *Problem:* As part of the Tax Cuts and Jobs Act (TCJA), Congress authorized taxpayers to claim a tax credit for dependents who do not meet the requirements of a qualifying child. In doing so, Congress did not require that the dependents have taxpayer identification numbers (TINs), but the IRS has imposed this requirement. This IRS-imposed requirement has rendered hundreds of thousands of otherwise qualifying dependents ineligible for credit claims.

- *Solution:* Clarify whether a dependent is required to have a TIN for purposes of the Credit for Other Dependents (ODC).

PRESENT LAW

IRC § 24 authorizes a Child Tax Credit (CTC) of up to $2,000 per qualifying child, of which up to $1,400 is refundable.[1] The TCJA added a new provision to IRC § 24 that allows a nonrefundable credit of $500 for each dependent who is not a qualifying child.[2] This nonrefundable credit is found in IRC § 24(h)(4) and referred to as the ODC.

IRC § 24(e) provides that a qualifying child must have a TIN. IRC § 24(h)(7) provides that, through 2025, the qualifying child's TIN must be a Social Security number (SSN) valid for employment in the United States.

Under IRC § 24(h)(4), the ODC is available for a "dependent of the taxpayer (as defined in section 152)." There is no requirement in IRC § 152 that an individual have a TIN (either an SSN or an individual taxpayer identification number) to be a dependent. IRC § 24(h)(4)(C) specifically provides that if a qualifying child's lack of an SSN prevents a taxpayer from claiming the CTC for that child, the taxpayer may receive the ODC for that child.

REASONS FOR CHANGE

Despite the absence of a TIN requirement in the statute, the IRS has taken the position that a dependent must have a TIN to be claimed for purposes of the ODC.[3] The IRS has used its summary assessment

1 For tax year 2021, the American Rescue Plan Act made this credit fully refundable and increased the credit to $3,000 for children under 18 and to $3,600 for children under six. Pub. L. No. 117-2, § 9611, 135 Stat. 4, 144-145 (2021).

2 Pub. L. No. 115-97, § 11022, 131 Stat. 2054, 2073 (2017) (applicable to taxable years beginning after Dec. 31, 2017, and before Jan. 1, 2026).

3 *See, e.g.,* IRS, Form 1040 (and 1040-SR) Instructions 18-19 (Dec. 27, 2023), https://www.irs.gov/pub/irs-pdf/i1040gi.pdf; IRS, 2023 Instructions for Schedule 8812, at 1 (Dec. 6, 2023), https://www.irs.gov/pub/irs-pdf/i1040s8.pdf.

authority to disallow the ODC claimed by nearly 390,000 taxpayers on their returns from Tax Years 2018 to 2023 (as of October 2024) because their dependents did not have TINs.[4]

In response to an inquiry from TAS, the IRS Office of Chief Counsel explained its legal rationale as follows:

> [I]n order to avoid treating dependents for whom a taxpayer may claim a credit under section 24(h)(4)(A) [i.e., the ODC] inconsistently, section 24(e)(1) [which imposes a TIN requirement for claiming a "qualifying child" for a credit under section 24] should be interpreted as applying to all dependents for whom a taxpayer claims a credit under section 24(h)(4)(A), not only a qualifying child described in section 24(h)(4)(C) [i.e., a "qualifying child" who lacks the SSN required by section 24(h)(7)].[5]

We question whether the IRS may legally impose a TIN requirement for the ODC. It is a basic principle of statutory interpretation that the unambiguous language of a statute controls.[6] Here, there is no statutory requirement that a dependent have a TIN to be claimed for the ODC. The IRS has imposed the requirement on its own.

The TCJA legislative history shows that Congress considered a TIN requirement and did not adopt it. The House version of the TCJA included a requirement that a dependent have a TIN for purposes of the ODC, but the subsequent Senate version of the TCJA did not. The enacted bill followed the Senate approach.[7]

To resolve the inconsistency between the absence of a TIN requirement in the ODC statute and the IRS's decision to impose the requirement on its own, the National Taxpayer Advocate recommends that Congress clarify its intent.

RECOMMENDATION

- Clarify whether a dependent is required to have a TIN for purposes of the ODC under IRC § 24(h)(4).

4 We presume the IRS exercised its summary assessment authority in reliance on IRC § 6213(g)(2)(I), which defines "mathematical or clerical error" to include "an omission of a correct TIN required under section 24(e) (relating to child tax credit) to be included on a return." The nearly 390,000 taxpayers include both primary and secondary taxpayers on married filing joint returns and correspond to 269,795 tax returns. IRS, Compliance Data Warehouse, Individual Returns Transaction File, TY 2018-2023 (Oct. 2024). If $500 of ODC was claimed with respect to each dependent, then the total amount of disallowed ODC would be about $287 million (*i.e.*, 574,550 multiplied by $500).

5 Email from the Office of Division Counsel/Associate Chief Counsel (National Taxpayer Advocate Program) to TAS Management & Program Analyst (Dec. 19, 2019) (on file with TAS). The email does not contain references or citations to any legal authority for this position.

6 *See, e.g.*, *Babb v. Wilkie*, 589 U.S. 399, 413 (2020) ("In any event, where, as here, the words of [a] statute are unambiguous, the judicial inquiry is complete.") (internal quotations omitted); *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992) ("We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there.").

7 *See* H.R. Rep. No. 115-466, at 225-227 (2017) (Conf. Rep.), https://www.congress.gov/115/crpt/hrpt466/CRPT-115hrpt466.pdf. It is possible that a drafting error was made, but if so, Congress – not the IRS – should correct it. Indeed, a technical correction was proposed but was not enacted. *See* Staff of J. Comm. on Tax'n, 115th Cong., Tech. Explanation of the House Ways and Means Comm. Chairman's Discussion Draft of the "Tax Tech. and Clerical Corr. Act" 4, JCX-1-19 (J. Comm. Print 2019), https://www.jct.gov/publications.html?func=startdown&id=5154.

Legislative Recommendation #59

Allow Members of Certain Religious Sects That Do Not Participate in Social Security and Medicare to Obtain Employment Tax Refunds

SUMMARY

- *Problem:* Members of certain religious sects, most notably the Amish, do not accept Social Security or Medicare benefits, and the law consequently exempts them from the requirement to pay Social Security and Medicare taxes if their employers are members of the same religious sect. However, the exemption does not apply if they work for employers who are *not* members of the same religious sect. These conflicting outcomes burden individuals who work for non-sect employers, as they are required to pay Social Security and Medicare taxes for benefits they will neither claim nor receive.

- *Solution:* Allow members of recognized religious sects who work for employers who are not members of such sects to claim a refund or credit for employment taxes paid.

PRESENT LAW

IRC § 3101 imposes a tax on wages paid to employees to fund old-age, survivors, and disability insurance (Social Security) and hospital insurance (Medicare) pursuant to the Federal Insurance Contributions Act (FICA).[1] IRC § 3111 requires employers to pay FICA tax at the same rate on their employees' wages.[2]

IRC § 1401 imposes a comparable tax on self-employed individuals pursuant to the Self-Employment Contributions Act (SECA). This tax is paid in full by the self-employed individual.

Members of the Amish community sought exclusions from these taxes because the tenets of their religion prohibit them from accepting social insurance benefits. In response, Congress enacted IRC § 1402(g), which exempts self-employed individuals who are members of certain religious faiths from the requirement to pay SECA tax. An individual may apply for an exemption from SECA tax by filing IRS Form 4029, Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits,

> … if he is a member of a recognized religious sect or division thereof and is an adherent of established tenets or teachings of such sect or division by reason of which he is conscientiously opposed to acceptance of the benefits of any private or public insurance which makes payments in the event of death, disability, old-age, or retirement or makes payments toward the cost of, or provides services for, medical care (including the benefits of any insurance system established by the Social Security Act).[3]

Congress subsequently enacted IRC § 3127 to exempt employers from paying their portion of FICA tax under IRC § 3111, provided that both the employer and the employee are members of the same recognized religious sect, both the employer and the employee are adherents of established tenets or teachings of the sect,

1 Under IRC § 3101, a tax of 6.2 percent is imposed on employee wages to fund old-age, survivors and disability insurance, and a tax of 1.45 percent is imposed to fund hospital insurance. In certain circumstances, employee wages are subject to an additional 0.9 percent tax to further fund hospital insurance (Additional Medicare Tax). Employers are generally required to withhold FICA taxes from their employees' wages under IRC § 3102(a).

2 Because IRC §3111 imposes an excise tax on the employer at the same rate with respect to the employee's wages, it is commonly understood that FICA tax is paid half by the employer and half by the employee.

3 IRC § 1401(g)(1).

and both the employer and employee file and receive approval for exemption from their respective portions of FICA tax.[4] The employer and employee must each receive approval by filing IRS Form 4029.[5]

IRC § 6413(b) requires the IRS to refund any overpayment of a taxpayer's FICA tax.

REASONS FOR CHANGE

The exemptions under IRC §§ 1402(g) and 3127 do not extend to members of recognized religious sects who work for employers who are not members of the same or any religious sect. Members of these sects therefore are paying for Social Security and Medicare benefits that their religious beliefs prohibit them from accepting. The National Taxpayer Advocate believes this result is inequitable and is inconsistent with the taxpayer's *right to a fair and just tax system*. The rationale for exempting self-employed Amish workers and Amish employees of Amish employers, as the law currently provides, applies equally to Amish employees who work for non-Amish employers.[6]

This inequity can be resolved by amending IRC § 6413 to allow employees who are members of a recognized religious group and work for an employer who is not a member of the same recognized religious group to file a refund claim for their portion of remitted FICA tax. Amish leaders have expressed a preference for allowing Amish employees of non-Amish employers to recover the employee's portion of the FICA tax through a refund claim, rather than by exempting the employee from paying the FICA tax, to avoid imposing an additional recordkeeping burden on employers and thereby potentially deterring employers from hiring them.[7]

RECOMMENDATION

- Amend IRC § 6413 to allow employees who meet the definition of "a member of a recognized religious sect or division thereof " in IRC § 1402(g) to claim a credit or refund of the employee's portion of FICA taxes withheld from their wages.[8]

4 IRC § 3127 establishes the requirements for employers and employees who are members and adherents of the same recognized religious sect to be exempt from their respective FICA tax obligations as required under IRC §§ 3101 and 3111. If the employer is a partnership, all partners of that partnership must be members of and adhere to the tenets of the same recognized religious sect. All partners of the partnership must apply and be approved individually for the exemption. Treas. Reg. § 31.3127-1(a).

5 For more information regarding the Form 4029 exemption application for members of recognized religious sects, see IRS, Pub. 517, Social Security and Other Information for Members of the Clergy and Religious Workers (Dec. 4, 2023), https://www.irs.gov/pub/irs-pdf/p517.pdf.

6 IRC § 1402(g). The discussion in this legislative recommendation applies to any member of a recognized religious sect or division thereof as described in this provision. Historically, the Amish and Mennonites have been the religious groups that have utilized this provision.

7 Meeting between TAS and Amish leaders (Aug. 16, 2019). If this recommendation is enacted, an employer who is not a qualifying member of a recognized religious sect would remain liable for his or her portion of the FICA tax pursuant to IRC § 3111.

8 For legislative language generally consistent with this recommendation, see Religious Exemptions for Social Security and Healthcare Taxes Act, H.R. 6183, 117th Cong. § 2 (2021).

Legislative Recommendation #60

Remove the Requirement That Written Receipts Acknowledging Charitable Contributions Must Be "Contemporaneous"

SUMMARY

- *Problem:* To claim certain types of charitable contributions, a taxpayer must obtain a contemporaneous written acknowledgment from the donee organization within a short time after making the contribution. Taxpayers who do not obtain a written acknowledgment by the deadline are not eligible for the deduction, even if they made the contribution and can otherwise substantiate it.

- *Solution:* Eliminate the requirement that the written acknowledgment must be "contemporaneous."

PRESENT LAW

IRC § 170(a) authorizes deductions for charitable contributions made during a taxable year. To claim a deduction of $250 or more, however, a taxpayer must substantiate the contribution with a "contemporaneous written acknowledgment" from the donee organization, as required by IRC § 170(f)(8)(A). To be "contemporaneous," IRC § 170(f)(8)(C) requires that the acknowledgment be received on or before the earlier of the date on which the tax return is filed or the date on which the tax return is due (including extensions). If the acknowledgment is sent late or if a timely but defective acknowledgment is not supplemented with needed information until after the deadline, the taxpayer is not eligible for the deduction, regardless of whether the taxpayer otherwise qualifies for it.[1]

Under IRC § 170(f)(8)(B), the acknowledgment must include the following information:

(i) The amount of cash and a description (but not value) of any property other than cash contributed.

(ii) Whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i).

(iii) A description and good-faith estimate of the value of any goods or services referred to in clause (ii) or, if such goods or services consist solely of intangible religious benefits, a statement to that effect.

"Contemporaneous" timing requirements are also found in IRC § 170(f)(12) relating to contributions of vehicles and IRC § 170(f)(18) relating to contributions to donor-advised funds.

REASONS FOR CHANGE

Strict contemporaneous timing requirements harm taxpayers and tax-exempt organizations that make a technical mistake in their written acknowledgments or that provide some required or corrected information after the statutory deadline has passed.

1 *See, e.g.*, *Albrecht v. Comm'r*, T.C. Memo. 2022-53, n.4 (where a timely obtained written acknowledgment was found insufficient to meet the content requirements for substantiation under IRC § 170(f)(8)(B), the court could not consider additional documentation that supplied the missing information because the donee organization provided it after the contemporaneous recordkeeping deadline).

Example: Assume a taxpayer contributes over $250 to a school's Parent Teacher Association (PTA). They receive an acknowledgment letter from the PTA thanking them for the donation and stating the contribution amount, but the letter fails to state that no goods or services were provided in consideration for the donation. The taxpayer notices the omission of this language as they are preparing their tax return and asks the PTA to send them a corrected acknowledgement. If the corrected acknowledgement is provided even one day after the taxpayer files their return, they will be ineligible for the deduction. If they were to contest this outcome in the Tax Court, the judge would not have the discretion to allow the deduction, even if the evidence conclusively showed the contribution was made and no goods or services were provided in exchange.[2]

In another context, Congress has acknowledged that a "contemporaneous" recordkeeping requirement was overly burdensome on taxpayers. In 1984, Congress added a contemporaneous recordkeeping requirement in IRC § 274(d) (requiring contemporaneous substantiation of certain expenses, including the business use of vehicles) due to concern about significant overstatements of deductions. Yet by 1985, it concluded the contemporaneous recordkeeping requirement "sweeps too broadly and generally imposes excessive recordkeeping burdens on many taxpayers."[3] Congress repealed the "contemporaneous" requirement while retaining the rules governing the content of the information that must be substantiated.[4] IRC § 274(d) now requires a taxpayer to substantiate a claimed expense by adequate records or by sufficient evidence corroborating the taxpayer's own statement establishing the amount, time, place, and business purpose of the expense.

Under similar reasoning, removing the "contemporaneous" component of the written acknowledgment requirements in IRC § 170 would still require taxpayers to provide sufficient evidence to substantiate their deductions, but it would reduce taxpayer burden and give the IRS and the courts common-sense flexibility in administering the law.

RECOMMENDATION

- Remove the "contemporaneous" component of the written acknowledgment requirements in IRC § 170(f)(8), (f)(12), and (f)(18).[5]

2 *See*, *e.g.*, *Durden v. Comm'r*, T.C. Memo. 2012-140.
3 S. Rep. No. 99-23, at 3 (1985); H.R. Rep. No. 99-34, at 4 (1985).
4 Pub. L. No. 99-44, § 1, 99 Stat. 77 (1985).
5 Conforming changes may be required in IRC §§ 2522 and 6720.

Legislative Recommendation #61

Establish a Uniform Standard Mileage Deduction Rate for All Purposes

SUMMARY

- *Problem:* The IRC authorizes taxpayers to deduct the costs of operating an automobile for several purposes. In combination with administrative guidance, however, it authorizes different standard mileage rates for each purpose. This is complicated and confusing for taxpayers, tax professionals, and IRS employees alike.

- *Solution:* Establish a uniform mileage deduction rate for all purposes.

PRESENT LAW

There are currently three different standard mileage deduction rates: one for business miles, one for charitable miles, and a third for medical transportation and military relocation miles. The rate for charitable miles is fixed by the IRC. The mileage rates for other purposes are not fixed by the IRC. Instead, the IRS generally adjusts the mileage rates annually.[1] Revenue Procedure 2019-46 states that the IRS will adjust the mileage rates in an annual notice.[2]

- *Business Miles:* IRC § 162 authorizes a deduction for the ordinary and necessary expenses a taxpayer pays or incurs during the taxable year, including the costs of operating an automobile used in the business. In 2024, the mileage deduction for business purposes was 67 cents per mile.[3]
- *Charitable Miles:* IRC § 170 authorizes a deduction for the use of an automobile in providing free services to a charitable organization. IRC § 170(i) sets the mileage deduction for providing free services to a charitable organization at 14 cents per mile. This amount was set in 1998, was not indexed for inflation, and has not been changed since that time.[4]
- *Medical and Military Moving Miles:* Deductions for the costs of operating an automobile are currently permitted for transport to medical care (see IRC § 213) and for military moving purposes (see IRC § 217). In 2024, the standard mileage rate for these purposes was 21 cents per mile.[5]

The IRS sets the standard mileage rate for business purposes by adding the fixed and variable costs of operating a motor vehicle. It sets the standard mileage rate for medical transportation and military relocation automobile expenses based solely on variable costs. Taxpayers have the option to calculate the actual costs of operating a vehicle in lieu of claiming the standard mileage allowance.[6]

1 *See* IRC § 62; Treas. Reg. §§ 1.62-2, 1.274-5.
2 2019-49 I.R.B. 1301, https://www.irs.gov/pub/irs-drop/rp-19-46.pdf.
3 IRS News Release, IR-2023-239, IRS Issues Standard Mileage Rates for 2024; Mileage Rate Increases to 67 Cents a Mile, Up 1.5 Cents From 2023 (Dec. 14, 2023), https://www.irs.gov/newsroom/irs-issues-standard-mileage-rates-for-2024-mileage-rate-increases-to-67-cents-a-mile-up-1-point-5-cents-from-2023.
4 IRC § 170(i); Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 973, 111 Stat. 788, 898 (1997).
5 IRS News Release, IR-2023-239, IRS Issues Standard Mileage Rates for 2024; Mileage Rate Increases to 67 Cents a Mile, Up 1.5 Cents From 2023 (Dec. 14, 2023), https://www.irs.gov/newsroom/irs-issues-standard-mileage-rates-for-2024-mileage-rate-increases-to-67-cents-a-mile-up-1-point-5-cents-from-2023.
6 *Id.*

REASONS FOR CHANGE

The costs of operating a motor vehicle are the same regardless of whether the vehicle is used for business, charitable, medical, or military moving purposes. The use of three different rates causes confusion for taxpayers, tax professionals, and IRS employees. For example, someone may know the deduction rate for one purpose and, not realizing there are different rates, erroneously apply that rate for another purpose. Indeed, some civic minded self-employed individuals may claim mileage deductions for both business and charitable purposes on the same tax return. Not only do multiple rates cause confusion, but if a taxpayer uses the wrong rate, even inadvertently, he or she may be subject to a tax adjustment, penalties, and interest charges. This undermines public confidence in the fairness of the tax system. If a motor vehicle on average costs a certain amount to operate, that mileage rate should apply across the board.

Additionally, the National Taxpayer Advocate notes that the 14-cent standard mileage rate for charitable miles established in 1998 does not reflect the current costs of automobile usage. Mileage rates should be indexed for inflation.

RECOMMENDATIONS

- Establish a uniform standard mileage deduction rate for business, charitable, medical, and military moving expenses, harmonizing IRC §§ 162, 170(i), 213, and 217.[7]
- Index the standard mileage deduction rate for inflation.

7 Under current law, taxpayers claiming a deduction at the standard business mileage rate must reduce the basis of their vehicle by the amount attributable to depreciation. *See* IRC § 1016(a)(2); Rev. Proc. 2019-46, 2019-49 I.R.B. 1301, https://www.irs.gov/pub/irs-drop/rp-19-46.pdf. Similar basis reductions are not required for deductions relating to the use of a vehicle for charitable, medical, or military moving purposes. If Congress establishes a uniform mileage rate, it may wish to consider whether any corresponding changes to the basis adjustment rules would be appropriate.

Legislative Recommendation #62

Eliminate the Marriage Penalty for Nonresident Aliens Who Otherwise Qualify for the Premium Tax Credit

SUMMARY

- *Problem:* Nonresident aliens who are lawfully present in the United States are eligible to receive the Premium Tax Credit (PTC) to subsidize the cost of health insurance. Due to a possible glitch in drafting the law, however, a lawfully present nonresident alien who is married to another nonresident alien is barred from receiving the PTC. This creates a "marriage penalty" that may prevent affected persons from obtaining health insurance, thereby undermining the purpose of the PTC.
- *Solution:* Revise the PTC eligibility requirements to remove the marriage penalty for nonresident aliens who are lawfully present in the United States.

PRESENT LAW

To be eligible to enroll in health coverage through the Health Insurance Marketplace, an individual must live in the United States; be a U.S. citizen, U.S. national, or lawfully present person;[1] and not be incarcerated.[2]

IRC § 36B authorizes the PTC, a refundable credit that subsidizes the cost of eligible individuals' and families' premiums for health insurance purchased through the Marketplace. Eligibility for the PTC depends on several factors, including household income based on family size; eligibility for affordable coverage through an employer-sponsored plan that provides minimum value; and eligibility to enroll in government-provided health coverage like Medicare, Medicaid, or TRICARE.

IRC § 36B(c)(1)(C) provides that if a taxpayer is married at the close of the taxable year, the taxpayer may only claim the PTC if the taxpayer and the taxpayer's spouse file a joint return for that year.[3] IRC § 6013(a)(1) prohibits married taxpayers from filing a joint return if either spouse is a nonresident alien at any time during the taxable year. Under IRC § 6013(g) or (h), a nonresident alien who is married to a U.S. citizen or resident can choose to be treated as a resident for the entire year, which allows the filing of a joint return. If both spouses are nonresident aliens at the end of the year, however, no provision allows them to file a joint return, therefore barring them from receiving the PTC.

REASONS FOR CHANGE

The interaction of the above rules leads to an anomalous result that probably was not intended. Nonresident aliens who are lawfully present in the United States may be eligible for the PTC health insurance subsidy, except if they are married to another nonresident alien – a severe and unwarranted "marriage penalty." Taxpayers whose income levels qualify them for the PTC but cannot receive it are far less likely to be covered by health insurance, reducing their access to medical care and placing a greater burden on the U.S. healthcare system.

RECOMMENDATION

- Amend IRC § 36B(c)(1)(C) to eliminate the joint filing requirement for a nonresident alien who is married to another nonresident alien at the end of the taxable year.

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1 For a list of the immigration statuses that are considered "lawfully present," see *Immigration Status to Qualify for the Marketplace*, HealthCare.Gov, https://www.healthcare.gov/immigrants/immigration-status/ (last visited Oct. 9, 2024).

2 42 U.S.C. § 18032(f)(1)(B), (3).

3 Exceptions apply for victims of domestic abuse and spousal abandonment. *See* Treas. Reg. § 1.36B-2(b)(2)(ii); IRC § 7703(b).

Legislative Recommendation #63

Encourage and Authorize Independent Contractors and Service Recipients to Enter Into Voluntary Withholding Agreements

SUMMARY

- *Problem:* Independent contractors are not subject to wage withholding. Instead, they are required to pay their taxes on their own. Many do not. If the IRS audits them or otherwise detects their noncompliance, they become liable for unpaid tax, penalties, and interest charges. If the IRS does not detect their noncompliance, federal revenue collection is impaired.
- *Solution:* Encourage independent contractors and businesses to enter into voluntary withholding agreements.

PRESENT LAW

IRC Chapter 24, Collection of Income Tax at Source on Wages, provides for required withholding of taxes on wages paid to employees, certain gambling winnings, some pensions and annuities, amounts subject to backup withholding, and certain other payments. In addition, IRC § 3402(p) provides for voluntary withholding at the option of the income recipient on certain payments such as Social Security benefits, unemployment benefits, and other benefits.[1] IRC § 3402(p)(3) authorizes the Secretary to promulgate regulations to provide for withholding from any payment that does not constitute wages if the Secretary finds withholding would be appropriate and the payor and recipient of the payment agree to such withholding.[2]

Although the Secretary may issue guidance by publication in the Internal Revenue Bulletin describing payments for which withholding under a voluntary agreement would be appropriate,[3] the only such guidance issued to date is Notice 2013-77, dealing with dividends and other distributions by Alaska Native Corporations.[4]

IRC § 6654(a) generally imposes a penalty for failure to pay sufficient estimated tax during the year, computed by applying (i) the underpayment rate established under IRC § 6621, (ii) to the underpayment, (iii) for the period of the underpayment.

REASONS FOR CHANGE

Unlike employees, whose wage payments are subject to federal income tax withholding, independent contractors are generally responsible for paying their own income taxes. Independent contractors generally must make four estimated tax payments during the year. However, many independent contractors fail to make estimated tax payments for a variety of reasons and therefore face penalties under IRC § 6654. In addition,

1 IRC § 3402(p)(1)(C), (p)(2).

2 IRC § 3402(p)(3) authorizes the promulgation of regulations for withholding from (i) an employee's remuneration for services that do not constitute wages and (ii) any other agreed-upon source that the Secretary finds appropriate. The Secretary must find the withholding would be appropriate "under the provisions of [IRC Chapter 24, Collection of Income Tax at Source on Wages]." Payments made when a voluntary withholding agreement is in effect are treated as if they are wages paid by an employer to an employee for purposes of the income tax withholding provisions and related procedural provisions of subtitle F of the IRC.

3 *See* Treas. Reg. § 31.3402(p)-1(c).

4 IRS Notice 2013-77, 2013-50 I.R.B. 632, Voluntary Withholding on Dividends and Other Distributions by Alaska Native Corporations, https://www.irs.gov/pub/irs-drop/n-13-77.pdf.

some do not save enough money to pay their taxes at the end of the year. As a result, they face additional penalties and interest charges, and they may face IRS collection action, including liens and levies.

The absence of withholding on payments to independent contractors also has a negative impact on revenue collection. IRS National Research Program studies show that tax compliance is substantially lower among workers whose income taxes are not withheld.[5]

This problem may be increasing as more people are working in the so-called "gig economy." It is projected that by 2028 there will be about 90 million U.S. workers participating in the gig economy.[6] To reduce the risk they will not save enough money to pay their taxes, some independent contractors would prefer to have taxes withheld throughout the year, as they are for employees. There is a legitimate debate about the circumstances under which withholding should be required. However, the National Taxpayer Advocate believes the law should encourage workers and businesses to enter into voluntary withholding agreements when both parties wish to do so.

For many businesses, withholding on payments to independent contractors will not impose an additional burden. In addition to paying independent contractors, most large companies have full-time employees, such as administrative staff, so they already have procedures in place to withhold. The National Taxpayer Advocate understands some businesses may be reluctant to withhold due to concerns that the IRS may cite the existence of withholding agreements to challenge underlying worker classification arrangements. Although the existence of a withholding agreement is generally not a factor the IRS considers when determining whether a worker should be classified as an employee or independent contractor, clarifying this point in the law will provide both businesses and independent contractors with reassurance that entering into a voluntary withholding agreement will not affect worker classification.[7]

RECOMMENDATION

- Amend IRC § 3402(p) to clarify that when voluntary withholding agreements are entered into by parties for the withholding of income tax and these parties do not treat themselves as engaged in an employer-employee relationship, the IRS may not consider the existence of such agreements as a factor when challenging worker classification arrangements.[8]

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5 *See* IRS, Pub. 1415, Research Analysis and Applied Statistics Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2014-2016 (Oct. 2022), https://www.irs.gov/pub/irs-pdf/p1415.pdf.

6 *Gig Economy in the U.S. – Statistics & Facts*, Statista, July 3, 2024, https://www.statista.com/topics/4891/gig-economy-in-the-us.

7 *See* Treas. Reg. § 31.3121(d)–1(c); Rev. Rul. 87-41, 1987-1 C.B. 296; Internal Revenue Manual 4.23.5.7.1, Control Test (Dec. 10, 2013), https://www.irs.gov/irm/part4/irm_04-023-005r.

8 For legislative language generally consistent with this recommendation, see Small Business Owners' Tax Simplification Act of 2017, H.R. 3717, 115th Cong. § 9 (2017), https://www.congress.gov/bill/115th-congress/house-bill/3717.

Legislative Recommendation #64

Require the IRS to Specify the Information Needed in Third-Party Contact Notices

SUMMARY

- *Problem:* The IRS may contact third parties to obtain information or documentation relating to taxpayers. Recognizing that third-party contacts (TPCs) "may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community," Congress has required the IRS to provide advance notice to affected taxpayers. However, the IRS sometimes does not tell the taxpayer what information it is seeking or give the taxpayer a reasonable opportunity to provide the information so it can avoid a TPC.

- *Solution:* Require the IRS to provide taxpayers with a tailored notice that identifies the specific information it plans to request from a third party, unless advance notice would jeopardize the collection of tax or another statutory exception applies.

PRESENT LAW

IRC § 7602(c)(1) generally requires the IRS to give taxpayers notice before contacting third parties (*e.g.*, banks, employers, employees, vendors, customers, friends, and neighbors) to request information about them. The IRS may provide this TPC notice only if it intends to make a TPC during the period specified in the notice, which may not exceed one year. Generally, the IRS must send the notice at least 45 days before making the TPC.[1] No law expressly requires the IRS to let the taxpayer know what specific information it needs (or seeks to verify) before contacting third parties.

IRC § 7602(c)(3) waives the TPC notice requirement if (i) the taxpayer has authorized the contact; (ii) the IRS determines for good cause that providing notice would jeopardize the IRS's tax collection efforts or may involve reprisal against any person; or (iii) the contact is made in connection with a criminal investigation.

REASONS FOR CHANGE

The TPC notice requirement was enacted as part of the IRS Restructuring and Reform Act of 1998 (RRA 98).[2] The Senate report accompanying the bill explained that "taxpayers should have the opportunity to resolve issues and volunteer information before the IRS contacts third parties."[3] The House-Senate conference report accompanying RRA 98 stated that "in general [the TPC] notice will be provided as part of an existing IRS notice."[4] Based on the conference report language, the IRS implemented the TPC notice requirement by including generic language in Publication 1, Your Rights as a Taxpayer, which the IRS sends to taxpayers in a variety of circumstances, whether or not it plans to make a TPC.[5]

1 The 45-day requirement was enacted by the Taxpayer First Act (TFA). Pub. L. No. 116–25, § 1206, 133 Stat. 981, 990 (2019). The IRS has issued a notice of proposed rulemaking to address the TFA amendment that would shorten the 45-day notice period to ten days or eliminate it altogether under certain circumstances. *See* Advance Notice of Third-Party Contacts, 89 Fed. Reg. 20371, 20371-77 (proposed Mar. 22, 2024) (amending Treas. Reg. § 301.7602-2).

2 RRA 98, Pub. L. No. 105-206, § 3417(a), 112 Stat. 685, 757 (1998).

3 S. Rep. No. 105-174, at 77 (1998).

4 H.R. Rep. No. 105-599, at 277 (1998) (Conf. Rep.).

5 IRS, Pub. 1, Your Rights as a Taxpayer (Sept. 2017), https://www.irs.gov/pub/irs-pdf/p1.pdf. Under the heading "Potential Third Party Contacts," Pub. 1 states, in part: "[W]e sometimes talk with other persons if we need information that you have been unable to provide, or to verify information we have received."

When Congress enacted the Taxpayer First Act (TFA) in 2019, it rejected the generic approach of including the TPC language in Publication 1. The TFA amended IRC § 7602(c) to require the IRS to send the TPC notice only when it intends to make a TPC and to send the TPC notice at least 45 days before making the contact.[6] In explaining the change, the House report accompanying the TFA quoted testimony from a former IRS official, who said the then-existing TPC notice requirement was "useless and does not effectively apprise taxpayers that such contact will be made, to whom it will be made, or that the taxpayer can request a third party contact report from the IRS." The House report said TPCs "may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community." It also said the change would "provide taxpayers more of an opportunity to resolve issues and volunteer information before the IRS contacts third parties."[7]

If the IRS were to include TPC notices as part of an existing IRS notice (such as Form 4564, Information Document Request) that requests information from the taxpayer, the 45-day period would give the taxpayer a realistic opportunity to avoid a TPC by providing the information requested on the form.[8] However, the IRS generally does not include a request for that information with the TPC notice.[9]

A tailored notice that identifies the specific information the IRS plans to request from a third party would be more effective in motivating taxpayers to provide the information themselves. The IRS previously tailored TPC notices in this way.[10] Generating tailored notices would not unduly burden the IRS because most TPCs are made in the collection context, where the IRS is seeking assets rather than information; TPC notices in the collection context are not implicated by this recommendation.[11] In the subset of cases where the IRS is seeking specific information, identifying what information the IRS is seeking would empower the taxpayer to protect their reputation by providing the information themselves so the TPC is unnecessary. Thus, using tailored TPC notices is consistent with a taxpayer's *right to be informed* and *right to privacy*, which includes the right to expect enforcement to be no more intrusive than necessary,[12] and it might save IRS resources by reducing the number of TPCs.

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6 Pub. L. No. 116-25, § 1206, 133 Stat. 981, 990 (2019); *see* Advance Notice of Third-Party Contacts, 89 Fed. Reg. 20371, 20371-77 (proposed Mar. 22, 2024) (which would amend Treas. Reg. § 301.7602-2 to address TFA amendments and create several exceptions allowing it to shorten the 45-day notice requirement to 10 days or eliminate it altogether).

7 H.R. Rep. No. 116-39, pt. 1, at 44-45 (2019). This report accompanied H.R. 1957, 116th Cong. (2019). Congress ultimately made one change to H.R. 1957 unrelated to the TPC provision and enacted the TFA as H.R. 3151, 116th Cong. (2019). However, H.R. Rep. No. 116-39 remains the sole committee report explaining the TFA.

8 IRS Form 4564, Information Document Request (May 2023).

9 *See, e.g.*, Internal Revenue Manual 5.9.3.12.1, Third Party Contacts (May 26, 2020), https://www.irs.gov/irm/part5/irm_05-009-003r; IRS, Letter 3164, Third-Party Notice.

10 For further discussion, see National Taxpayer Advocate 2015 Annual Report to Congress 123, 127 (Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC15_Volume1_MSP_12_Third-Party-Contacts.pdf; National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 98 (Area of Focus: *IRS Third Party Contact (TPC) Notices Should Be More Specific, Actionable, and Effective*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/JRC18_Volume1_AOF_12.pdf.

11 TPCs often arise from IRS requests for payment from third parties, such as banks served with a levy for the taxpayer's funds on deposit or in connection with the advertising or conduct of public auction sales of the taxpayer's property. A prior TAS study found the IRS made TPCs in 68.1 percent of its field collection cases and 8.5 percent of its field examination cases. National Taxpayer Advocate 2015 Annual Report to Congress 123 (Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC15_Volume1_MSP_12_Third-Party-Contacts.pdf. This recommendation generally does not cover collection contacts, because in those cases, the IRS is not asking a third party for information that the taxpayer could provide.

12 *See* Taxpayer Bill of Rights (TBOR), https://www.taxpayeradvocate.irs.gov/get-help/taxpayer-rights (last visited Oct. 1, 2024). The rights contained in TBOR are also codified in IRC § 7803(a)(3).

RECOMMENDATION

- Amend IRC § 7602(c) to require the IRS to provide taxpayers with tailored notices that identify the specific information it plans to request from a third party. Before the IRS seeks such information from a third party, it should include the third-party contact notice with another IRS notice requesting such information in order to give taxpayers a reasonable opportunity to respond and provide the required information, unless an exception under IRC § 7602(c)(3) applies.[13]

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13 If the taxpayer responds, the IRS may still contact a third party if it has a legitimate need to interview witnesses or corroborate information provided by the taxpayer.

Legislative Recommendation #65

Enable the Low Income Taxpayer Clinic Program to Assist More Taxpayers in Controversies With the IRS

SUMMARY

- *Problem:* In 1998, Congress created the Low Income Taxpayer Clinic (LITC) grant program to provide free or nominal-cost representation to low-income taxpayers involved in controversies with the IRS and to provide education about taxpayer rights and responsibilities to taxpayers who speak English as a second language (ESL). The law capped the grant that could be awarded to any clinic at $100,000 per year. The law also limited the grant amount a clinic may receive to the amount it raises from other sources. These restrictions prevent the LITC Program from assisting as many low-income taxpayers as it otherwise could.
- *Solution:* Eliminate the annual $100,000 per-clinic funding cap and reduce the matching funds requirement when doing so would expand coverage to additional taxpayers.

PRESENT LAW

IRC § 7526 authorizes the Secretary, subject to the availability of appropriated funds, to provide matching grants for the development, expansion, or continuation of LITCs. The IRS Restructuring and Reform Act of 1998 authorized the LITC Program to provide free or nominal-cost representation to low-income taxpayers who are involved in controversies with the IRS and to provide education about taxpayer rights and responsibilities in multiple languages for ESL taxpayers.

IRC § 7526(c)(1) imposes an annual aggregate limitation of $6 million for LITC grants "[u]nless otherwise provided by specific appropriation."

IRC § 7526(c)(2) imposes an annual limitation on grants to a single clinic of $100,000.[1]

IRC § 7526(c)(5) limits the amount of LITC funding a clinic may receive to the amount it raises from other sources (*i.e.*, a 100 percent matching funds requirement). The match may be in cash or third-party in-kind contributions (*e.g.*, volunteer time, donated supplies).

REASONS FOR CHANGE

The LITC Program is an effective and low-cost means to assist low-income and ESL taxpayers. In 2024, the LITC Program Office awarded grants to 138 organizations in 44 states and the District of Columbia. In 2024, clinics receiving grant funds represented over 20,000 taxpayers dealing with IRS tax controversies, including in cases before the U.S. Tax Court. They provided consultations or advice to over 17,000 additional taxpayers. The clinics worked closely with the Tax Court and the IRS Office of Chief Counsel to resolve docketed cases on a pre-trial basis where possible. They helped taxpayers secure more than $11 million in tax refunds and reduced or corrected taxpayers' liabilities by more than $40 million. They also brought thousands of taxpayers back into filing and payment compliance, and helped ensure that individuals understood their rights and

1 In recent appropriations acts, Congress has doubled the per-clinic cap from $100,000 to $200,000. *See, e.g.*, Consolidated Appropriations Act, 2024, Pub. L. No. 118-47, 138 Stat. 460, 526 (2024). This change has been helpful, but appropriations legislation is annual, and several clinics have told us they are reluctant to invest in raising additional matching funds and hiring and training additional employees unless they have assurance that these higher funding levels will be made available in future years. For that reason, we continue to recommend raising the caps in the authorizing legislation (*i.e.*, IRC § 7526).

responsibilities as U.S. taxpayers by conducting more than 1,800 educational activities that were attended by over 91,000 individuals.[2]

The success of the LITC Program is tied largely to the extensive use of volunteers. Over 1,500 volunteers contributed to the success of LITCs by volunteering about 42,000 hours of their time.[3]

There are many underserved low-income taxpayers across the nation who could benefit from LITC assistance. The overriding goal of LITC management is to provide quality service to more taxpayers. IRC § 7526 currently contains two restrictions that limit expansion of the LITC Program to serve additional taxpayers.

First, the annual limitation on grants to a single clinic of $100,000, which has remained unchanged since 1998, prevents the LITC Program Office from awarding additional funds to qualified clinics that have demonstrated excellence in assisting low-income and ESL taxpayers and the ability to efficiently handle more cases. Even if the restriction were to be retained, the $100,000 cap enacted in 1998 would have to be raised to nearly $200,000 simply to reflect the effects of inflation.[4] However, the LITC Program Office could ensure more taxpayers receive LITC services if it is given discretion to provide larger grants to clinics that demonstrate they can use the funds productively. The objective is not to create a small number of "super clinics"; we believe it is important to maintain maximum geographic coverage for taxpayers across the United States. Rather, as more taxpayers are becoming comfortable working with service providers remotely and as the Tax Court has begun to offer virtual trial sessions, we believe some clinics will be able to achieve economies of scale that will allow them to serve considerably more taxpayers at comparatively less cost, including taxpayers in areas that do not currently have an LITC.[5]

Second, the 100 percent matching funds requirement in some cases serves as a barrier to coverage. The purpose of the match requirement is to ensure that each clinic's management has a broad commitment to assisting taxpayers and to encourage clinics to recruit tax professionals on a volunteer basis to assist additional taxpayers. In general, strong clinics do not have difficulty meeting the requirement, and we believe the match requirement generally should be retained. But in certain circumstances, resources to meet the match requirement may be limited. The LITC Program Office has encountered difficulty identifying and funding clinics in certain geographic areas, and a lower match requirement should make it economically feasible for additional clinics to operate.

In addition, if our recommendation to eliminate the $100,000 per-clinic funding cap is adopted, clinics that can meet the 100 percent matching funds requirement when receiving grants of $100,000 may have difficulty raising funds in excess of $100,000 on a 1:1 basis. Thus, clinics awarded grants in excess of $100,000 should not be held to the same 100 percent matching funds requirement. The same is true for new clinics that are trying to get off the ground in underserved areas. Taxpayers would be better served if the LITC Program Office is given the discretion, delegated by the Secretary of the Treasury, to reduce the matching percentage in these circumstances (but not below 25 percent) where doing so would expand coverage to additional taxpayers.

2 Email from Management and Program Analyst, TAS LITC Program Office (Oct. 25, 2024) (providing updated data for 2024).

3 *Id*.

4 *See* U.S. Bureau of Labor Statistics, CPI Inflation Calculator, https://www.bls.gov/data/inflation_calculator.htm (last visited Oct. 18, 2024).

5 In 2019, Congress authorized an analogous program, the Volunteer Income Tax Assistance (VITA) matching grant program, which provides free tax return preparation for individuals with low to moderate incomes (*i.e.*, below the maximum Earned Income Tax Credit threshold), individuals with disabilities, and individuals with limited English proficiency. The VITA statute, IRC § 7526A, was modeled after the LITC statute but does not impose any limitation on the amount that may be awarded to a qualifying grantee.

RECOMMENDATIONS

- Eliminate the $100,000 per-clinic funding cap imposed under current law by removing subsection (2) from IRC § 7526(c) and renumbering subsequent subsections accordingly.
- Amend IRC § 7526(c)(5) to retain the 100 percent "matching funds" requirement as the general rule but provide that the Secretary has the discretion to allow a lesser matching rate (but not less than 25 percent) where doing so would expand coverage to additional taxpayers.[6]

6 For legislative language generally consistent with this recommendation, see Low-Income Taxpayer Clinic Modernization Act of 2024, H.R. 8876, 118th Cong. § 2 (2024).

Legislative Recommendation #66

Compensate Taxpayers for "No Change" National Research Program Audits

SUMMARY

- *Problem:* To refine its audit selection formulas, the IRS audits a randomly selected group of taxpayers each year, effectively making them "guinea pigs" to help it improve the way it does its job. These National Research Program (NRP) audits impose burdens on the selected taxpayers, as they often incur fees for representation by a tax professional, must devote considerable time to gathering and organizing requested documentation, and experience the stress of an IRS audit.

- *Solution:* Absent fraud, compensate taxpayers who undergo NRP audits that do not result in changes to their tax liabilities and consider waiving any tax, interest, and penalties that result from these audits.

PRESENT LAW

There is no provision under present law that authorizes compensation of taxpayers who are audited under the IRS's NRP or provides relief from the assessment of tax, interest, and penalties that may result from NRP audits.

REASONS FOR CHANGE

Through the NRP, the IRS conducts audits of randomly selected taxpayers. The NRP benefits tax administration by enabling the IRS to gather strategic information about taxpayer compliance behavior as well as information about the causes of reporting errors. This information helps the IRS update its workload selection formulas and thereby enables it to focus its audits on returns with a relatively high likelihood of error. It also helps the IRS to estimate the "tax gap." In addition, NRP studies benefit Congress by providing taxpayer compliance information that is useful in formulating tax policies.

For the thousands of individual taxpayers (or businesses) that are subject to NRP audits, however, they impose significant burdens.[1] In essence, these taxpayers, even if fully compliant, serve as "guinea pigs" to help the IRS improve the way it does its job. They must contend with random and sometimes intensive audits that consume their time, drain resources (including representation fees), and may impose an emotional and reputational toll.

In 1995, the House Ways and Means Subcommittee on Oversight held a hearing on the NRP's predecessor, the Taxpayer Compliance Measurement Program (TCMP).[2] Testimony provided during the hearing, and subsequent witness responses to questions-for-the-record, indicated that TCMP audits imposed a heavy burden on taxpayers and reflected a strong view that audited taxpayers were bearing the brunt of a research project intended to benefit the tax system as a whole. Proposals raised at the hearing included compensating taxpayers selected for TCMP audits as well as possibly waiving tax, interest, and penalties assessed during the audits.

1 IRS, Form 1040 – Individual Income Tax, National Research Program, https://nrp.web.irs.gov/1040-study.html (last visited Aug. 27, 2024).

2 *Taxpayer Compliance Measurement Program: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 104th Cong. (1995), https://www.govinfo.gov/content/pkg/CHRG-104hhrg20681/pdf/CHRG-104hhrg20681.pdf.

Following the hearing, the House Budget Committee included a proposal in its 1995 budget reconciliation bill to compensate individual taxpayers by providing a tax credit of up to $3,000 for TCMP-related expenses.[3] Ultimately, this proposal was not adopted. Instead, the IRS was pressured to stop conducting TCMP audits. The inability to perform regular TCMP audits, however, undermined effective tax administration because it prevented the IRS from updating its audit selection formulas. Using older formulas likely meant that more compliant taxpayers faced (unproductive) audits and that audit revenue declined.

About a decade later, the IRS reinstated the TCMP under the new NRP name. Some procedures have since changed, but the burden on many of these taxpayers remains substantially unchanged. For the same reasons identified during the 1995 House hearing, the National Taxpayer Advocate believes it is appropriate to recognize that taxpayers audited under the NRP are bearing a heavy burden to help the IRS improve the effectiveness of its compliance activities. A tax credit or authorized payment would alleviate the monetary component of the burden. Further relief could be provided by waiving any assessment of tax, interest, and penalties resulting from an NRP audit.[4] However, this waiver should not apply where tax fraud or an intent to evade tax is uncovered in an NRP audit.

RECOMMENDATIONS

- Compensate taxpayers for "no change" NRP audits through a tax credit or other means.[5]
- Consider waiving the assessment of tax, interest, and penalties resulting from an NRP audit, absent fraud or an intent to evade federal taxes.

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3 *See* H.R. Rep. No. 104-280, vol. 2, at 28 (1995).

4 Alternatively, legislation could require NRP-audited taxpayers to pay any additional tax owed and limit relief to interest and penalties. However, to the extent the purpose of NRP audits is to identify areas where NRP-audited taxpayers are underreporting tax so the IRS can revise its audit selection formulas, a waiver of tax as well as interest and penalties may be more effective, as taxpayers might be more forthcoming with auditors if they are assured they will not face additional assessments (absent fraud).

5 For legislative language that would allow a deduction for certain individual taxpayers of up to $5,000 for qualified NRP expenses, see Small Business Taxpayer Bill of Rights Act of 2023, S. 1177 and H.R. 2681, 118th Cong. § 14 (2023).

Legislative Recommendation #67

Improve Tax and Financial Literacy by Promoting Interagency Collaboration and Modernizing the Requirement That the IRS Publish Graphics Summarizing Government Revenue and Spending

SUMMARY

- *Problem:* Limited tax and financial literacy is a significant problem in this country that has costly consequences for taxpayers and the government alike. In 2003, Congress took an important step to improve financial literacy by creating the Financial Literacy and Education Commission (FLEC), whose members are 24 federal agencies. FLEC has a range of duties related to promoting financial literacy and education, but none specifically address tax literacy. Separately, Congress has required the IRS to publish pie charts showing major income and outlay categories in the instructions for the Form 1040. This requirement, enacted in 1990 when paper instructions were the norm, does not capture current data visualization practices.
- *Solution:* Amend 20 U.S.C. § 9703 to include the promotion of tax literacy among the duties of the FLEC or create a separate multi-agency commission focused on tax literacy, and modernize the requirement that the IRS publish graphics showing government revenue and spending.

PRESENT LAW

In 2003, Congress created FLEC, a multi-agency task force responsible for developing a national strategy on financial education.[1] 20 U.S.C. § 9703(a)(1) directs FLEC, through the authority of its members, "to take such actions as it deems necessary to streamline, improve, or augment the financial literacy and education programs, grants, and materials of the Federal Government, including curricula for all Americans." 20 U.S.C. § 9703(a)(2) directs FLEC to emphasize "basic personal income and household money management and planning skills." 20 U.S.C. § 9703 imposes additional requirements on FLEC, such as developing best practices for teaching financial literacy to higher education students, maintaining a website that is a clearinghouse for information about federal financial literacy and education programs, and developing and disseminating materials to promote financial literacy and education to the public.

IRC § 7523(a), enacted in 1990, requires the IRS to include in a prominent place in the instructions for Form 1040 two pie-shaped charts showing the relative sizes of "major outlay categories" and "major income categories."[2] IRC § 7523(b)(1) defines major outlay categories as (1) defense, veterans, and foreign affairs; (2) Social Security, Medicare, and other retirement; (3) physical, human, and community development; (4) social programs; (5) law enforcement and general government; and (6) interest on the debt.
IRC § 7523(b)(3) requires the chart for major outlay categories to include footnotes that break down some of the categories, such as the percentages of the defense outlays for veterans and foreign affairs.
IRC § 7523(b)(2) defines major income categories as (1) Social Security, Medicare, and unemployment and other retirement taxes; (2) personal income taxes; (3) corporate income taxes; (4) borrowing to cover the deficit; and (5) excise, customs, estate, gift, and miscellaneous taxes.

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1 Financial Literacy and Education Improvement Act, Pub. L. No. 108-159, Title V, § 513, 117 Stat. 1952, 2003 (2003) (codified at 20 U.S.C. §§ 9701-9707); *see also* U.S. Dep't of the Treasury, *Financial Literacy and Education Commission*, https://home.treasury.gov/policy-issues/consumer-policy/financial-literacy-and-education-commission (last visited Oct. 24, 2024).

2 Pub. L. No. 101-508, Title XI, § 11622(a), 104 Stat. 1388, 1388-504 (1990).

REASONS FOR CHANGE

Limited tax and financial literacy is a significant problem in this country.[3] In 2023 alone, it is estimated that insufficient financial literacy in the United States cost more than $388 billion, or about $1,506 per adult.[4]

Having a basic understanding of taxes and the U.S. tax system is important because taxes influence how people make decisions that impact many areas of their lives. Tax and financial literacy are intertwined in financial decision-making, including managing a household budget, saving for retirement, paying for education, buying a house, and starting or expanding a small business. Filing a tax return is often a prerequisite for obtaining loans and other financial resources required for success and stability, including small business loans, home mortgages, and federal student aid.

The National Taxpayer Advocate commends the IRS for its efforts to work with other federal agencies to promote taxpayer education and outreach. However, significant knowledge gaps remain. There is a need for the IRS and other federal agencies to develop a more coordinated approach to providing tax-focused education in a meaningful and systemic way and to incorporate tax literacy content into other agencies' financial literacy programming. Congress took an important step to improve financial literacy in this country when it created FLEC. In its two decades of existence, FLEC has performed an impressive array of work, including developing a financial education website, holding public hearings on important issues related to financial literacy, and issuing reports that look at financial literacy from a variety of perspectives.[5] The National Taxpayer Advocate encourages Congress to show a similar commitment to tax literacy by amending the law that created FLEC to include duties related to promoting tax literacy or creating a separate multi-agency commission focused on tax literacy.

Another way in which Congress can promote tax literacy is by updating the requirements in IRC § 7523. An important component in tax literacy is understanding the role of the U.S. tax system. The public benefits from seeing where the money that funds the government comes from and the purposes for which the government uses it, and it is likely that some taxpayers who perceive that connection will be more compliant with their tax obligations. The requirements in IRC § 7523 are outdated, reflecting that they were enacted in 1990 when paper instructions were the norm. Today, there are better ways to visualize and present this data to the public. To give taxpayers a more complete picture of the role of taxes in our lives, the National Taxpayer Advocate recommends that Congress amend IRC § 7523 to modernize its requirements by directing the IRS to develop and post graphics on IRS.gov that present information on government revenue and spending in a way that uses plain language and incorporates technology to provide an interactive data visualization experience.[6]

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3 *See* National Taxpayer Advocate 2024 Annual Report to Congress, www.taxpayeradvocate.irs.gov/AnnualReport2024.

4 Nat'l Financial Educators Coun., *Financial Illiteracy Cost Americans $1,506 in 2023*, https://www.financialeducatorscouncil.org/financial-literacy-costs (last visited Oct. 19, 2024).

5 For examples of FLEC's reports, see U.S. Dep't of the Treasury, *Financial Literacy and Education Commission*, *Resources*, https://home.treasury.gov/policy-issues/consumer-policy/financial-literacy-and-education-commission.

6 For additional background, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 9 (*Require the IRS to Provide Taxpayers With a "Receipt" Showing How Their Tax Dollars Are Being Spent*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC19_PurpleBook_01_StrengthRights_3.pdf.

RECOMMENDATIONS

- Amend 20 U.S.C. § 9703 to include the promotion of tax literacy among the duties of FLEC or create a similar multi-agency commission focused on tax literacy.
- Amend IRC § 7523 to require the IRS to develop, post on IRS.gov, and update at least annually graphics that present information on government revenue and spending in an accessible manner and that use interactive data visualization to provide taxpayers with an understanding of the U.S. tax system. Also, require the IRS to publicize the availability of this information.

Legislative Recommendation #68

Establish the Position of IRS Historian Within the Internal Revenue Service to Record and Publish Its History

SUMMARY

- *Problem:* Unlike many other federal agencies, the IRS does not have a historian to catalog and publish an analysis of its successes and failures. This is significant because many of the challenges the IRS faces are recurring, such as its decades-long efforts to modernize its information technology systems and its efforts to strike the appropriate balance between collecting delinquent taxes and respecting taxpayer rights. To cite an adage, those who fail to learn from history are doomed to repeat it.

- *Solution:* Establish the position of IRS historian within the IRS to catalog and publish analyses of the agency's successes and failures.

PRESENT LAW

The IRS, as a federal agency, is required to properly maintain and manage its records under the Federal Records Act[1] and to provide public access to these records under the Freedom of Information Act.[2] However, the IRS is not required to publish a historical analysis of its tax administration programs and policies.

REASONS FOR CHANGE

The IRS's mission, priorities, and challenges have remained relatively constant over time. For example, even with the significant funding the Inflation Reduction Act (IRA) has given the IRS to transform tax administration and taxpayer services, the IRS's IRA Strategic Operating Plan (SOP) for fiscal years 2023-2031 conveys similar themes to prior strategic plans, including to:

- Dramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible.
- Quickly resolve taxpayer issues when they arise.
- Focus expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap.
- Deliver cutting-edge technology, data, and analytics to operate more effectively.
- Attract, retain, and empower a highly skilled, diverse workforce and develop a culture that is better equipped to deliver results for taxpayers.[3]

For the most part, these themes and objectives have been the same for several decades, and they are likely to remain so for the foreseeable future.[4] As IRS officials retire and are replaced and as leaders in the oversight community (including Congress, the Government Accountability Office, and the Treasury Inspector General

1 44 U.S.C. §§ 3101-3107.

2 5 U.S.C. § 552.

3 IRS, Pub. 3744, IRS Inflation Reduction Act Strategic Operating Plan (Apr. 2023), https://www.irs.gov/pub/irs-pdf/p3744.pdf; IRS, Pub. 3744-A, 2024 IRA Strategic Operating Plan Annual Update Supplement (Apr. 2024), https://www.irs.gov/pub/irs-pdf/p3744a.pdf.

4 Some parts of the IRS's mission have evolved. Increasingly, the IRS has been called upon to administer social benefits programs (*e.g.*, the Earned Income Tax Credit and child tax credit) and to administer financial relief payments (*e.g.*, stimulus payments during the pandemic). As is apparent in the IRA SOP, technology, data, and analytics are also increasingly important to the agency. In these areas, too, a thorough history would help policymakers pinpoint where and how additional resources should be targeted.

for Tax Administration) retire and are replaced, new leaders would benefit enormously from an objective recording and assessment of prior IRS initiatives to achieve its strategic goals.

Numerous offices of history operate in the executive, judicial, and legislative branches.[5] Government historians serve various roles, such as researching and writing for publication and internal use, editing historical documents, preserving historical sites and artifacts, and providing historical information to the public through websites and other media.[6] Historians should be objective and accurate.[7] For example, the Historian of the Department of State is required to publish a documentary history of the foreign policy decisions and actions of the United States, including facts providing support for and alternative views to policy positions ultimately adopted, without omitting or concealing defects in policy.[8] Historians in federal agencies promote transparency and accountability in this way. Because more U.S. citizens interact with the IRS than any other federal agency, the public interest and potential benefits of learning from the agency's successes and failures are particularly high.

During the early 1990s, the IRS decided to hire an IRS historian. However, the relationship was tense, and the individual who held the position told Congress that the IRS undermined her work and fought transparency, concluding that "the IRS shreds its paper trail, which means there is no history, no evidence, and ultimately no accountability."[9] The IRS eliminated the position and never hired a historian again. The National Taxpayer Advocate believes the IRS should be required to have a historian to assist it in avoiding mistakes of the past and to promote transparency.

RECOMMENDATION

- Add a new subsection to IRC § 7803 to establish the position of IRS historian within the IRS. The IRS historian should have expertise in federal taxation and archival methods, be appointed by the Secretary of the Treasury in consultation with the Archivist of the United States, and report to the Commissioner of Internal Revenue. The duties of the IRS historian require access to IRS records, including tax returns and return information (subject to the confidentiality and disclosure provisions of IRC § 6103). The IRS historian should be required to report IRS history objectively and accurately, without omitting or concealing defects in policy.[10]

5 *History at the Federal Government*, Soc'y for History in the Fed. Gov't, https://shfg.wildapricot.org/history-at-fedgov (last visited Aug. 16, 2024).

6 Soc'y for History in the Fed. Gov't, Historical Programs in the Federal Government: A Guide (1992), https://shfg.wildapricot.org/Historical-Programs-Guide.

7 *Id*.

8 22 U.S.C. § 4351(b).

9 *See Practices & Procedures of the Internal Revenue Service, Hearings Before the S. Comm. on Finance*, 105th Cong. 35 (1997) (statement of Shelley Davis, former IRS Historian).

10 For additional background, see National Taxpayer Advocate 2011 Annual Report to Congress 582 (Legislative Recommendation: *Appoint an IRS Historian*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/2011_ARC_Legislative-Recommendations.pdf.

Legislative Recommendation #69

Postpone Tax Deadlines for Hostages and Individuals Wrongfully Detained Abroad

SUMMARY

- *Problem:* U.S. taxpayers who are held hostage or wrongfully detained in foreign countries generally cannot file tax returns or make tax payments, yet under current law they may be subject to interest charges and penalties that the IRS does not have the legal authority to waive.
- *Solution:* Automatically postpone tax filing and payment deadlines for hostages and individuals who are wrongfully detained abroad and their spouses and provide for the refund or abatement of penalties, interest, and other additional amounts assessed.

PRESENT LAW

IRC § 7508A(a) gives the Secretary of the Treasury or her delegate the authority to postpone the deadline for performing certain acts under the internal revenue laws for a taxpayer determined by the Secretary or her delegate to be affected by a terroristic[1] or military action as defined in IRC § 692(c)(2).[2] IRC § 7508A(a) limits a deadline postponement to one year in response to each terroristic or military action.

REASONS FOR CHANGE

Individuals who are held hostage or wrongfully detained abroad must currently rely on the Secretary's discretionary authority to postpone the deadlines to submit tax filings, make tax payments, and perform other time-sensitive tax-related actions. Additionally, the Treasury Secretary's discretionary authority to postpone these deadlines is limited to up to one year. Individuals who are held hostage or wrongfully detained abroad should not have to rely on the Treasury Secretary's discretionary authority to relieve them from the consequences of their inability to meet their tax obligations. Additionally, the duration of the postponement should match the duration of the hostage's or detainee's inability to meet their tax obligations and should not be subject to a one-year limit.

RECOMMENDATION

- Establish an automatic postponement of the tax deadlines set forth in IRC § 7508(a)(1), as incorporated in IRC § 7508A(a)(1), for individuals who are held hostage or unlawfully detained abroad (and their spouses) that extends for the duration the hostage or detainee is unable to comply with their time-sensitive tax obligations due to being held hostage or unlawfully detained, plus one year.[3]

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1 IRC § 692(c)(2) defines a terroristic action as "any terroristic activity which a preponderance of the evidence indicates was directed against the United States or any of its allies."

2 Section 4.01(1) of Revenue Procedure 2004-26, 2004-1 C.B. 890, provides that prior to publishing a determination that an event outside the United States constitutes a terroristic action within the meaning of IRC § 692(c)(2), the Secretary or her delegate will ascertain whether the Department of State and the Department of Justice believe that a preponderance of the evidence indicates the event resulted from terrorist activity directed against the United States or its allies.

3 For legislative language generally consistent with this recommendation, see Stop Tax Penalties on American Hostages Act of 2024, S. 4057, 118th Cong. § 2 (2024). If the non-detained spouse is due a refund because of overwithholding or excess estimated tax payments, the non-detained spouse should be authorized to file a current return to receive the refund and then file a superseding joint return with the detained spouse for up to one year after the detained spouse's release.