Executive Summary

Preface & Highlights

NATIONAL TAXPAYER ADVOCATE

Annual Report to Congress

2018

www.TaxpayerAdvocate.irs.gov/2018AnnualReport

This report is dedicated to

the employees of the
Internal Revenue Service and
the Taxpayer Advocate Service,

who, despite experiencing economic hardship and anxiety
during the recent government shutdown,
returned to work with energy and dedication;

&

to my staff

who worked night and day
to get this report out in record time
on their return from the shutdown.

I am forever grateful.

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PREFACE: Introductory Remarks by the National Taxpayer Advocate, Including an Analysis of the Initial Effects of the Government Shutdown

I respectfully submit for your consideration the National Taxpayer Advocate's 2018 Annual Report to Congress. Section 7803(c)(2)(B)(ii) of the Internal Revenue Code (IRC) requires the National Taxpayer Advocate to submit this report each year and in it, among other things, to identify at least 20 of the most serious problems encountered by taxpayers and to make administrative and legislative recommendations to mitigate those problems. The statute requires the National Taxpayer Advocate to submit the report by December 31, 2018; however, as I discuss later in this preface, the lapse in IRS funding meant that no TAS employees were excepted to work on finalizing the report. Thus, I am submitting the report in February 2019.

This report was conceived, back in February 2018, as a baseline representation of the IRS at that point in time. We thought it would be a helpful document for both Congress and the new Commissioner—to know where things stood, from the perspective of the taxpayers' advocate, on the eve of the first filing season under a new tax law. We wanted to reflect the taxpayer's journey as he or she navigates the tax system, from obtaining answers to tax law questions before filing to litigating tax issues in court. Hence the title of the Most Serious Problems section—"The Taxpayer's Journey"—and the organization of that section reflecting phases of the taxpayer's experience with the IRS, along with a section of "roadmaps" depicting that journey.[1] One of our goals in creating these roadmaps was to help readers understand the complexity of the taxpayer journey. It was challenging for us to create these roadmaps and will probably be difficult for readers to follow them, which hints at the extreme frustration many taxpayers experience when they must interact with the IRS. IRS employees also experience that a frustration as they try to navigate the system. For every step shown on the roadmaps, I note there are multiple sub-steps and detours that we did not represent, for fear of getting ourselves and everyone else completely lost.[2]

Then came the longest government shutdown in the history of the United States. The Annual Report staff was furloughed, along with most of TAS. On January 28, when my office reopened, it was clear that the IRS baseline had changed. The five weeks could not have come at a worse time for the IRS—facing its first filing season implementing a massive new tax law, with a completely restructured tax form. As I outline below, the IRS is entering the filing season inundated with correspondence, phone calls, and inventories of unresolved prior year audits and identity theft cases.

Lurking under all of these are profound Information Technology (IT) systems issues. The IRS systems that constitute the official record of taxpayer accounts—the Individual Master File and the Business Master File—are the oldest in the federal government and for the last 25 years the IRS has tried—and been unable—to replace them. Taxpayer information is stored in over 60 separate case management systems, so the IRS has no 360-degree view of taxpayer data. The IRS has no enterprise case selection system, so it can't be sure it is focusing on the right taxpayers or the right issues in its outreach, audit, and collection activities.

1 *See The Taxpayer's Journey: Roadmaps of the Taxpayer's Path Through the Tax System*, *infra*.

2 We hope to convert the roadmaps into an electronic version this year, so taxpayers can input a notice or letter number and see where they are on their "journey."

The IRS desperately needs to replace its antiquated technology systems. Indeed, this is the agency's #1 need. Last year, the IRS experienced a systems crash on the final day of the tax-filing season, forcing the IRS to extend the filing season by a day. The crash prompted talk of the risk of a catastrophic systems collapse, and that risk does, indeed, exist. But there is a greater risk: IRS performance already is significantly limited by its aging systems, and if those systems aren't replaced, the gap between what the IRS should be able to do and what the IRS is actually able to do will continue to increase in ways that don't garner headlines but increasingly harm taxpayers and impair revenue collection.

And that matters a great deal because the IRS is effectively the accounts receivable department of the federal government. In fiscal year (FY) 2018, it collected nearly $3.5 trillion on a budget of $11.43 billion—a return on investment of about 300:1. Yet funding for IRS technology upgrades—provided through the Business Systems Modernization (BSM) account—has been very limited in both absolute and relative terms. As the following chart shows, BSM funding was reduced by 62 percent from FY 2017 ($290 million) to FY 2018 ($110 million) and constituted just one percent of the agency's overall appropriation in FY 2018.

FIGURE 1, IRS Appropriations – Fiscal Years 2017–2019[3]

Fiscal Year	BSM Funding	Total IRS Funding	BSM as % of Total IRS Funding
2017	$290 M	$11.24 B	2.6%
2018	$110 M	$11.43 B	1.0%
2019 (House Bill)	$200 M	$11.62 B	1.7%
2019 (Senate Bill)	$110 M	$11.26 B	1.0%

Congressional funding for the BSM account has been limited in part because the IRS has not done a good job of planning and executing technology upgrades in the past. More funding should be made available subject to accountability measures. But given the additional revenue and improved taxpayer service state-of-the-art technology is likely to bring in, I believe spending for new systems going forward should be measured in billions—not millions. In this report, our #1 legislative recommendation is that Congress provide the IRS with additional dedicated, multi-year funding to replace its core IT systems—pursuant to a plan that sets forth specific goals and metrics and is evaluated annually by an independent third party so that Congress is not merely writing the agency a blank check.

But that is forward-looking. In recent years, modernization efforts have started and stopped, in part because of funding fluctuations and in part because constant legislative changes have absorbed almost half of the IRS's IT bandwidth during the last six years, according to IRS officials. In short, the IRS is stretched to its breaking point.

This is the IRS's baseline. Because our Report was written before the shutdown, in this preface I shall attempt to describe some of the initial effects of the shutdown on the IRS, including TAS, and on U.S.

3 For fiscal year (FY) 2017 IRS funding levels, see Consolidated Appropriations Act, 2017, Pub. L. No. 115-31, Division E, 131 Stat. 135, 331-334 (2017). For FY 2018 IRS funding levels, see Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, Division E (2018). At this writing, the FY 2019 appropriations act that funds the Treasury Department has not been finalized. For House-proposed funding levels, see H.R. Rep. No. 115-792, at 14 (2018) (accompanying H.R. 6258, which was subsequently incorporated into and passed by the House as H.R. 6147, Division B, at 168-176, 115th Cong. (2018)). For Senate-proposed funding levels, see S. Rep. No. 115-281, at 25 (2018) (accompanying S. 3107, at 12-19, 115th Cong. (2018)).

taxpayers. (The full effect will become clearer months, and even years, down the road.) I will also point out where the shutdown exacerbated trends we already identified in the Most Serious Problems section of this report. I will discuss the impact of these interruptions on IRS IT modernization efforts and advocate for multi-year funding for those efforts. And I will recommend that Congress at the very least exempt the IRS from the operation of the Anti-Deficiency Act.

Before I discuss these issues, I want to express my deep appreciation to, and admiration for, the IRS workforce, including but not limited to employees in the Taxpayer Advocate Service. Most IRS employees experienced financial challenges as a result of missing two pay checks. Some employees could not pay their bills and others were deeply worried they would miss payments if the shutdown continued for much longer. Yet when the shutdown ended, IRS employees returned to work with energy and generally hit the ground running, eager to make sure the agency could deliver the filing season as well as achieve its broader mission. The IRS faces many challenges as an agency—and this report documents many of them—but the dedication of the IRS workforce is a notable bright spot.

IRS Operations Before the Shutdown

On December 21, 2018, the day before the shutdown, the IRS was already struggling with its inventory of work. During 2018, the IRS shuffled resources around to meet the challenge of implementing the new tax law while wrestling with record inventory levels of unresolved cases in its fraud detection programs.[4] In addition, the IRS was directed to replace all the existing Individual Income Tax Return forms—the 1040, 1040A, and 1040EZ—with a single new Form 1040. This new form was reduced to the size of a postcard, two half pages in length, on which it is estimated approximately 47 million taxpayers (32 percent) could meet their filing requirements. By reducing the 1040 to a postcard size, however, this redesign necessitated the creation of an additional six schedules, some containing only three lines of information. Thus, for approximately 70 percent of taxpayers—nearly 102 million—the six new schedules increase the number of already existing schedules, such as A, B, C, D, or E, that taxpayers must complete.[5] While many taxpayers will use software to complete the return, the new schedules will force some taxpayers to cross-reference and transfer data such as credits, deductions, and income, increasing the potential for errors to occur since the tax information is dispersed over many pages and needs to be tracked down and reported on different schedules and forms.

The new tax law also required a "surge" of tax instructions and publications, as well as notices, FAQs, and regulations. IRS functions were asked to detail employees to the IRS Forms and Publications office for six months and longer to enable it to keep up with the demand and schedule. Chief Counsel guidance projects that were long scheduled and anticipated were put on hold while Counsel attorneys focused on interpreting major provisions of the new tax law. Once again, as with the Patient Protection and Affordable Care Act (ACA)[6] and the Foreign Account Tax Compliance Act (FATCA)[7], key IT personnel were moved from ongoing modernization or enhancement efforts to work on delivery of the

4 *See* Most Serious Problem: *False Positive Rates: The IRS's Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers*, *infra*.

5 TAS research estimates that 68 percent of taxpayers will need to file one or more schedules of the 2018 Form 1040 based on tax year (TY) 2016 tax return filing data. IRS Compliance Data Warehouse (CDW), Individual Returns Transactions File, TY 2016. For example, using the new 1040, a taxpayer with unemployment compensation, student loan interest deduction, and child and dependent care expenses will now have to file Schedules 1 and 3, whereas with the 2017 1040, they only needed to file the main form, which was two pages.

6 *See* Patient Protection and Affordable Care Act (ACA) of 2009, Pub. L. No. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act (HCERA) of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

7 *See* Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71 (2010) (adding Chapter 4 of Internal Revenue Code (IRC) §§ 1471-1474; 6038D), collectively referred to as the Foreign Account Tax Compliance Act (FATCA).

new tax law and forms. Because of the revamp of the tax forms, the electronic filing requirements were not issued to private tax software vendors and electronic return originators until September 2018, much later than in previous years.

While the 2018 filing season went well for millions of taxpayers (excluding the filing glitch on April 17, 2018, which led to the IRS extending the filing season by a day), the IRS's fraud detection system wreaked havoc for hundreds of thousands of taxpayers and created manual rework for IRS employees. The IRS's fraud detection filters and models identify questionable refund returns. As we recount in the Most Serious Problem *Fraud Detection: The IRS's Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers*, however, the part of the process that was supposed to recycle returns back through the wage database as new wage data came in from employers and the Social Security Administration completely failed, requiring the IRS to *manually upload* wage data and *manually process* frozen returns through the system. It was not until late July 2018 that the IRS had waded through all the frozen refund returns and determined which were legitimate and which were not.

The result of this process was an 81 percent False Positive Rate (FPR). *That is, of all the returns initially frozen by this system as suspect, 81 percent were legitimate.* Of the returns still unreleased one month after the initial freeze, 64 percent were legitimate. Not surprisingly, taxpayers did not take this lying down. TAS cases involving this issue increased by 287 percent from January 2018 through September 2018, and for the first time ever, the NTA Case Intake line experienced two-hour wait times, as taxpayers called desperate to figure out when their refunds would be released.[8]

The fraud detection debacle had another consequence—frozen refund returns with Earned Income Tax Credit (EITC) claims were sent to the examination function, which was not prepared for this onslaught of cases. Thus, on December 21, 2018, the day before the shutdown, the IRS had not worked through its inventory of tax year (TY) 2017 EITC audits, meaning it was starting the 2019 filing season already behind in that category of work.

Meanwhile, the perennial staffing declines—well documented in past Annual Reports—continued to negatively affect the IRS's ability to deliver its audit and collection workplans, leading to across-the-board efforts to "streamline" audits and collection.

- With respect to the IRS examination function, we show in this report that the IRS's field audit selection is deeply flawed, resulting in no change rates on average of 23 percent for audits conducted by the Small Business/Self-Employed Division (SB/SE) and 32 percent for audits conducted by the Large Business and International Operating Division (LB&I).[9]
- The IRS correspondence examination function, which conducts 71 percent of all audits (individual and business), has the highest no response and lowest agreement rates of any audit type, and none of the audit streams measure the future compliance of the taxpayers who were audited, or whether those taxpayers understood what they did wrong.[10]

8 Taxpayer Advocate Management Information System; TAS, Aceyus Phone Reporting System (Feb. 20, 2018).

9 IRS, CDW, AIMS FY 2010 through FY 2018 (Dec. 2018). Due to the lapse in appropriations, LB&I did not provide a timely response to our request to verify these figures during the TAS Fact Check process. For a detailed discussion of the field audit process, see Most Serious Problem: *Field Examination: The IRS's Field Examination Program Burdens Taxpayers and Yields High No-Change Rates, Which Waste IRS Resources and May Discourage Voluntary Compliance*, *infra.*

10 *See* Most Serious Problem: *Correspondence Exam: The IRS's Correspondence Examination Procedures Burden Taxpayers and are not Effective in Educating the Taxpayer and Promoting Future Voluntary Compliance*, *infra*.

In fact, a study we publish in this report shows that, overall, taxpayers in the study who experienced audits reported higher levels of fear, anger, threat and caution when thinking about the IRS and felt less protected by the IRS.[11] Taxpayers who experienced correspondence exams report a lower level of perceived justice compared to those who underwent office and field exams. A 2015 TAS study found that self-employed taxpayers filing a Schedule C who experience a no change audit reduced their reported income by 37 percent three years after the audit.[12] How the IRS conducts audits clearly has an effect on taxpayers' willingness to comply.

In collection, the IRS is *actively* discouraging and avoiding person-to-person conversations with taxpayers. It is intentionally not placing phone numbers on its correspondence or burying that information on the last page of multi-page communications.[13] Instead, it is pushing taxpayers to the internet to enter into "streamlined" installment agreements (IAs). It has expanded these streamlined IAs to six- and seven-year terms—that is, the taxpayer can agree to make monthly payments by dividing the tax debt by 72 or 84 months, without any financial analysis as to whether a taxpayer can actually afford to make these payments.[14]

No surprise, then, that TAS research found that in FY 2018:

- About 40 percent of taxpayers who entered into streamlined IAs within the Automated Collection System (ACS) had incomes at or below their Allowable Living Expenses (ALEs), meaning these taxpayers entered into IAs when they could not afford to pay their basic living expenses, according to the IRS's own definition.[15]
- About 39 percent of streamlined IAs within ACS involving taxpayers with income at or below their ALEs defaulted in FY 2018.[16]
- This sad situation is reproduced in the Private Debt Collection initiative, which utilizes the IRS's streamlined IA authority. In FY 2018, 37 percent of taxpayers defaulted on IAs entered into while assigned to the Private Collection Agencies (PCAs) and 40 percent of taxpayers who entered into PCA IAs had incomes below their ALEs.

All this taxpayer harm is driven by a lack of resources, and they are justified by the IRS as "efficiencies" and "Future State" initiatives. But these approaches are neither efficient nor effective. They represent a failure to conduct effective tax administration by not engaging with and educating the taxpayer and promoting future voluntary compliance.

This, then, was the state of affairs as of December 21, 2018, when the IRS shut down.

11 See Brian Erard, Matthias Kasper, Erich Kirchler, and Jerome Olsen, Research Study: *What Influence do IRS Audits Have on Taxpayer Attitudes and Perceptions? Evidence from a National Survey*, *infra*.

12 National Taxpayer Advocate 2015 Annual Report to Congress, vol. 2, 88 (Research Study: *Audit Impact Study*).

13 See Most Serious Problem: *Collection Due Process Notices: Despite Recent Changes to Collection Due Process Notices, Taxpayers Are Still at Risk for Not Understanding Important Procedures and Deadlines, Thereby Missing Their Right to an Independent Hearing and Tax Court Review*, *infra*.

14 See Most Serious Problem: *IRS's Automated Collection System (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS*, *infra*.

15 *Id.*

16 TAS Research analysis of the Individual Master File and Individual Returns Transaction File on installment agreements established in FY 2018. This figure assumes taxpayers have one IRS-allowed vehicle ownership and operating expense, and a second operating expense if they were married filing jointly. If we assume the taxpayers did not have vehicle ownership expenses, the default rate would be about 32 percent.

A Brief Primer on the Anti-Deficiency Act

Article I of the Constitution provides that "No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."[17] The Anti-Deficiency Act (ADA) implements this provision.[18] Specifically, 31 U.S.C. § 1341(a)(1)(B) forbids any officer or employee of the United States government or of the District of Columbia government to involve his or her respective government employer in a contract or obligation for the payment of money before an appropriation is made unless authorized by law. A significant exception to this rule is provided in 31 U.S.C. § 1342, which permits such government activity "for emergencies involving the safety of human life or the protection of property."

A 1981 Attorney General opinion clarified that two factors must be present for this exception to apply:

1. A reasonable and articulable connection between the obligation (the opinion involved a contract or grant) and the safety of life or the protection of property; and
2. Some reasonable likelihood that either the safety of life or the protection of property would be compromised to some significant degree by failure to carry out the function in question—and that the threat to life or property can be reasonably said to be near at hand and demanding of immediate response.[19]

A 1995 Department of Justice opinion reiterated the two-prong analysis and interpreted the 1990 amendment to the ADA, noting the emergencies exception only applies where the threat is "near at hand and demanding of immediate response."[20] It further concluded the threat must be significant in nature.

OMB guidance from 1981 excepts tax-related activities of the Treasury.[21] The way in which the IRS interprets this exception—not always consistently—can be seen in its shutdown plans. In 2011, some of the activities that the IRS included in the category of necessary for the safety of human life or protection of property were: processing of tax returns, taxpayer service centers and call sites, and protection of statute expiration, bankruptcy, liens and seizure cases.[22] The IRS excepted 57 TAS employees under this category in 2011. It also excepted 1,263 ACS employees to handle levy release calls from taxpayers.[23] In 2013, however, the IRS did not consider taxpayer service centers and call sites necessary for the safety of human life or protection of property exceptions, nor did it except any ACS employees to handle levy release calls from taxpayers. And no TAS employees, including the National Taxpayer Advocate, were excepted under the 2013 shutdown.

The IRS Office of Chief Counsel has adopted the position that the exception for protection of life and property applies only to prevent imminent loss of life or property and the protection of property exception applies only to *government* property.[24] Furthermore, Chief Counsel attorneys concluded that activities related to preventing significant hardship to individual taxpayers do not fit the exception. "The types of activities the [National Taxpayer Advocate] performs to prevent taxpayer hardship are

17 U.S. CONST. Art. I, § 9, cl. 7.

18 Pub. L. No. 97-258, 96 Stat. 923 (1982).

19 43 U.S. Op. Atty. Gen. 293, 302 (Jan. 16, 1981).

20 Office of Management and Budget (OMB), Memorandum M-95-18 Assistant Attorney General Walter Dellinger, *Memorandum for Alice Rivlin, Director, Office of Management and Budget* 9 (Aug. 16, 1995).

21 OMB, *Memorandum for Heads of Executive Departments and Agencies* 2 (Nov. 17, 1981).

22 *IRS FY 2011 Shutdown Contingency Plan (During Lapsed Appropriations)* 6 (Apr. 7, 2011).

23 *Id.* at 38.

24 Office of Chief Counsel, General Legal Services, *Points on Government Shutdown Issues Pertaining to National Taxpayer Advocate* (Sept. 27, 2013).

not the types of activities related to protecting the public welfare that OMB has identified."[25] Upon questioning by the National Taxpayer Advocate, Chief Counsel personnel maintained that "safety of life" applied only in the context of public health, such as meat inspectors. Thus, neither of these exceptions would allow personnel to be excepted to issue a refund or release a levy in order to allow the taxpayer to obtain access to funds to receive a life-saving operation, for example. Nor could the IRS use resources to release a levy where it is depriving the taxpayer of funds to pay for basic living expenses, even if the levy could leave the taxpayer homeless.

IRS 2018 Non-Filing Season Lapse Plan

On November 29, 2018, in anticipation of a lapse in funding, Treasury issued *IRS FY2019 Lapsed Appropriations Contingency Plan (Non-Filing Season - December 8-31, 2018)* that would apply in the event of a shutdown due to a lapse in appropriations outside the filing season. The plan identifies 9,946 employees, 12.5 percent of the IRS workforce, who would not be furloughed.

According to the plan:

- 3,337 IT employees would work during the shutdown, 1,457 of whom are in the Associate Chief Information Officer (ACIO) Enterprise Operations function, which is part of the Deputy Chief Information Officer for Tax Reform and Filing Season office. Of these 1,457 employees, 555 are in the Enterprise Computing Center (ECC) Division, which maintains IRS computer applications and prevents IRS computer processing from shutting down completely.
- Another 414 Small Business/Self-Employed (SB/SE) employees would be needed under the nonfiling season plan, 310 of whom work in collection, most often in field collection (165). Among other things, these employees process tax returns which include remittances, protect the government's interests in the context of statute expirations, bankruptcy, liens, and seizure cases, handle budget matters related to the lapse in appropriations, and administer contracts.
- Another 2,241 Wage and Investment (W&I) employees would be needed under the nonfiling season plan, of whom 1,029 are submission processing employees, to process tax returns that contain remittances; 374 W&I accounts management employees would also be needed to process remittances and for statute protection.

Under the plan, the National Taxpayer Advocate and Local Taxpayer Advocates (LTAs) would be excepted for purposes of periodically checking mail and processing payments. They would not be authorized to intake cases, issue Taxpayer Assistance Orders (TAOs), or take other actions to address significant hardships and emergencies, including ordering the release of liens or levies.

IRS 2019 Filing Season Lapse Plan

On January 15, 2019, the IRS issued the *IRS FY2019 Lapsed Appropriations Contingency Plan (Tax Year 2018 Filing Season)* to apply in the event of a shutdown due to a lapse in appropriations at any time during the TY 2018 filing season (January 1-April 30, 2019). The plan identifies 46,052 employees, 57.4 percent of the IRS workforce, who would not be furloughed.

25 Office of Chief Counsel, General Legal Services, *Points on Government Shutdown Issues Pertaining to National Taxpayer Advocate* 3 (Sept. 27, 2013).

According to the filing season plan 3,766 IT employees would work during the shutdown.

- The number of excepted employees in ACIO Enterprise Operations remained the same (1,457), but excepted employees in the ACIO User and Network Services increased to 627 from the nonfiling season plan level of 308. Among other things, these employees provide day-to-day maintenance of the IRS tax infrastructure.
- The number of excepted employees in ACIO, Applications Development, increased to 958 from the nonfiling season plan level of 798. These employees work to prevent loss of data in process and revenue collections, provide application support for critical systems, manage code, perform builds, process transmittals, and complete and test filing year programs.

The filing season shutdown plan calls for 2,938 excepted SB/SE employees, of whom 2,614 are collection employees.

- The number of excepted field collection employees remained the same as in the nonfiling season shutdown plan.
- The number of excepted campus collection employees increased from 64 employees in the nonfiling shutdown plan to 2,229. Most of these employees (1,839) are collection representatives, who respond to taxpayers who have received a collection notice through ACS, assist taxpayers with setting up installment agreements for tax payments, assist taxpayers with general collection processes, serve as the gateway for transferring taxpayers to Accounts Management for appropriate filing season inquiries, and provide assistance with releasing levies and liens as required by law. However, consistent with IRS Chief Counsel's position, later guidance clarified that these employees *are not* authorized to release levies and liens.[26]

In addition, the filing season shutdown plan provides for an SB/SE Mail Plan, for which 560 employees are needed.

- Of these, 250 collection employees protect statute expiration or assessment activities, protect bankruptcy or other revenue generating issues, oversee the collection of taxes and processing of returns, process tax returns which include remittances, complete computer operations necessary to prevent loss of data in process and revenue collections, handle budget matters related to the lapse in appropriations, and administer contracts.
- An additional 310 SB/SE Exam employees carry out similar tasks.

The filing season shutdown plan provides for 34,357 excepted W&I employees.

- Of these, 17,644 are accounts management employees (compared to 374 accounts management employees excepted under the nonfiling season plan). Of these employees, 17,520 are needed to process Form 1040X's and remittances, provide statute protection, support the Tax Cut and Jobs Act, and staff call sites.
- 13,469 submission processing employees are excepted (compared to 1,029 in the non-filing season plan). Of these, 13,000 are needed to process tax returns, Form 1040X remittances, and refunds.

26 *See* IRS SERP Alert #19A0017, *Release of Levy and Release of Lien* (Jan. 23, 2019) ("While there is a lapse in funding during the partial shutdown we are not authorized to take this action. We may do so once we are fully opened, so please call us back at that time. Please apologize to the taxpayer and explain we are not authorized to release the levy or lien due to the partial government shutdown. Explain that they may call us back after we are fully reopened.").

Treatment of Taxpayers Experiencing Economic Hardship Under the Lapse Plans

Under the 2018 and 2019 Lapse Plans, the National Taxpayer Advocate, Deputy National Taxpayer Advocate, and LTAs are excepted to check mail in order to process payments. However, with respect to the 2019 Filing Season Plan, Chief Counsel has opined that TAS acts "derivatively" in solving refund problems and addressing collection issues and therefore cannot conduct those activities during a shutdown.[27] Thus, despite the requirement under IRC § 6343(a)(1)(D) that the IRS release any levy that creates an economic hardship for a taxpayer, and the explicit charge in IRC § 7811(b)(1) that the National Taxpayer Advocate may issue a TAO "to release property of the taxpayer levied upon" where the taxpayer is experiencing significant hardship, no IRS or TAS employee, including the National Taxpayer Advocate, was excepted to work these cases.

Moreover, the Treasury Department determined that the completion and issuance of the statutorily-mandated National Taxpayer Advocate's Annual Report to Congress, which identifies at least 20 of the most serious problems facing taxpayers, did not meet the ADA exception as "authorized by necessary implication from the specific terms of duties that have been imposed on, or of authorities that have been invested in, the agency."[28]

Thus, during the first part of the shutdown, no IRS employees were authorized to answer the telephone lines, issue refunds, release liens and levies, enter into installment agreements, or review pending IRS actions. On January 22, under the 2019 Filing Season plan, IRS employees were excepted to answer the phone lines, issue refunds, and enter into installment agreements. They were not, however, authorized to release liens and levies, nor were TAS employees authorized to advocate on behalf of taxpayers who were experiencing significant hardship as a result of the IRS's actions or inactions.

Impact of the Shutdown on IRS Operations

As described earlier, on December 21, 2018, the IRS was already in a position of entering the filing season with a backlog of items and with its resources stretched thin. Figure 2 presents the state of various types of key work and measures on three key dates: December 22, 2018 (the first day of the shutdown); January 26, 2019, (the end of the fifth week of the shutdown when some employees were called back to work under the 2019 Filing Season Lapse Plan); and February 2, 2019 (the end of the first week of the filing season after the shutdown ended).

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27 The IRS Office of Chief Counsel opined as follows:

> We have determined that TAS may continue to issue manual refunds and enter into streamlined installment agreements, because TAS has authority to take these actions on behalf of IRS.
>
> In contrast, there are a number of functions listed in the Plan where TAS acts derivatively, serving as a conduit or advocate for action by other business units. This includes, for example, fixing refund issues and assisting with general collection processes. As to these derivative functions, we have concluded that there is insufficient evidence that Congress intended for the functions to continue during a lapse in appropriations. In reaching this conclusion, we relied on guidance from the Office of Legal Counsel (OLC). OLC has stated that there is implied authority for an unfunded function to continue during a lapse if the function is "necessary to the effective execution of" a function that has funding or is excepted, "such that suspension of the [unfunded] function[] … would prevent or significantly damage the execution of [the funded or excepted] function[]." OLC, *Effect of Appropriations for Other Agencies*, 19 Op. OLC 337, 338 (Dec. 13, 1995). Upon considering TAS's role and its statutory mandates, we do not believe that Congress has implied that suspension of TAS's derivative functions would prevent or significantly damage IRS's execution of its tax collection and refund issuance functions.

Email from Senior Counsel, General Legal Services to Deputy National Taxpayer Advocate (Jan. 17, 2019).

28 See Op. Attorney Gen. 293, 296-301 (1981). "Page 97 of the revised plan shows a number of Taxpayer Advocacy [sic] Service employees excepted to prepare the annual TAS report to Congress. Even though there is a specific statutory deadline for the report, we do not consider a reporting deadline of this type sufficient to create an implied exception to the Anti-Deficiency Act. Therefore, the exception on this basis will need to be removed before I can clear the plan as legally sufficient." Email from Deputy Director, Office of Emergency Preparedness, U.S. Department of Treasury (Nov. 30, 2018).

On January 24, 2019, the IRS had over 5 million pieces of mail that had not been batched for processing; it had 80,000 responses to FY 2018 Earned Income Tax Credit audits that had not been addressed; it had 87,000 amended returns waiting to be processed.[29] During the shutdown, the National Distribution Center's (NDC) inventory grew to about 170,000 orders.[30] Despite employees working overtime to process about 11,000 orders a day, the IRS announced that orders for Forms W-2 and W-3 were backlogged and would not be finished shipping out until mid-February. By law, employers are required to file these information returns by January 31; the IRS therefore suggested that employers consider requesting filing extensions.

At key points in the return processing pipeline, inventories were up over 100 percent over the same time in 2018. For the week ending January 26, 2019 (the last week of the shutdown), the level of service (LOS) on the Accounts Management phone lines was 36.8 percent and the average speed of answer (ASA) was 32 minutes. The LOS and ASA for the Installment Agreement/Balance Due phone lines was abysmal—12.8 percent and 93 minutes respectively. By February 2, 2019, the end of the first week after the shutdown ended—that is, the first week of the filing season—most levels only slightly improved. There was one significant exception: the LOS for the Balance Due/Installment Agreement line was 6.7 percent. *This means for that week 93.3 percent of the taxpayers calling to make payment arrangements were unable to speak to a live assistor.*

29 IRS Senior Leadership Appropriations Lapse Daily Call (Jan. 25, 2019).

30 Email from Commissioner, Wage & Investment (W&I) Operating Division, to National Taxpayer Advocate (Jan. 24, 2019).

FIGURE 2, Selected IRS Inventories and Levels of Service Pre-Shutdown and Post-Shutdown

Description	Week Ending 12/22/2018	Week Ending 1/26/2019	% Change from Week Prior to Shutdown to Week Ending 1/26/2019	Week Ending 2/2/2019	% Change from Week Prior to Shutdown to Week Ending 2/2/2019
Level of Service for the Accts. Mgmt. [a]	75.4%	36.8%	-51.2%	48.3%	-35.9%
Average Speed of Answer (AM) [b]	12.8	31.9	149.2%	17.0	32.8%
Level of Service for ACS [c]	69.1%	30.9%	-55.3%	38.3%	-44.6%
Average Speed of Answer (ACS) [d]	15.7	51.9	230.6%	48.3	207.6%
Level of Service for the Installment Agreement/Bal. Due Line [e]	54.6%	12.8%	-76.6%	6.70%	-87.7%
Average Speed of Answer for the Installment Agreement/Bal. Due Line [f]	23.2	93.00	300.9%	80.6	247.4%

a IRS, Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot* (Dec. 23, 2017, Jan. 27, 2018, Feb. 3, 2018, Dec. 22, 2018, Jan. 26, 2019, and Feb. 2, 2019).

b *Id*.

c IRS, JOC, *Snapshot Reports: Product Line Detail* (Dec. 23, 2017, Jan. 27, 2018, Feb. 3, 2018, Dec. 22, 2018, Jan. 26, 2019, and Feb. 2, 2019).

d *Id*.

e *Id*.

f *Id*.

Figure 3 shows where the IRS was in terms of several key work measures and the percentage change for all these activities when compared to the same period for the prior year. Immediately before the shutdown, the IRS's main phone line was significantly improved over the same period the year before (75.4 percent LOS for FY 2019 compared to 56.8 percent LOS in FY 2018).[31] But the difference between FY 2018 and FY 2019 for levels of service and wait times for *all phone lines* at the end of the shutdown and the first week all employees returned is … shocking. For example, the LOS for both the Accounts Management and ACS phone lines experienced at least a 56 percent decrease in FY 2019 from FY 2018 levels.[32] For the week ending February 2, 2019, which was the first week of the filing season, these same lines continued to show a decrease of over 40 percent from FY 2018 levels. Specifically, the Accounts Management lines had 48 percent LOS and a 17 minute wait time, compared to 86 percent LOS and a 4 minute wait time in FY 2018; the ACS lines had a 38 percent LOS and 48 minute wait time, compared to a 65 percent LOS and a 19 minute wait time in FY 2018.[33]

Make no mistake about it, these numbers translate into real harm to real taxpayers. And they represent increased rework for the IRS downstream, at a time when the IRS is already resource challenged. The IRS will be facing tough decisions as it revises its workplans for FY 2019 in light of the shutdown's impact.

31 IRS, Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot* (Dec. 22, 2018).

32 IRS, Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot* (Jan. 26, 2018); IRS, Joint Operations Center (JOC), *Snapshot Reports: Product Line Detail* (Jan. 26, 2018).

33 IRS, Joint Operations Center (JOC), *Snapshot Reports: Enterprise Snapshot* (Feb. 2 2018); IRS, Joint Operations Center (JOC), *Snapshot Reports: Product Line* Detail (Feb. 2, 2018).

FIGURE 3, Selected IRS Inventories and Levels of Service Pre-Comparison to Last Year for Week Ending Prior to Shutdown, Week Ending at Conclusion of Shutdown, and Week after Operations Resumed

Description	Week Ending 12/23/2017	Week Ending 12/22/2018	Percent Change from Corresponding Week of Prior Year	Week Ending 1/27/2018	Week Ending 1/26/2019	Percent Change from Corresponding Week of Prior Year	Week Ending 2/3/2018	Week Ending 2/2/2019	Percent Change from Corresponding Week of Prior Year
Level of Service for the Accts. Mgmt. Lines	56.8%	75.4%	32.7%	84.2%	36.8%	-56.3%	86.2%	48.3%	-44.0%
Average Speed of Answer (AM) Minutes	16.4	12.8	-22.0%	4.6	31.9	593.5%	4.4	17.0	286.4%
Level of Service for ACS	63.7%	69.1%	8.5%	72.7%	30.9%	-57.5%	64.5%	38.3%	-40.6%
Average Speed of Answer (ACS) Minutes	18.9	15.7	-16.9%	11.4	51.9	355.3%	19.2	48.3	151.6%
Level of Service for the Bal. Due Line	59.8%	54.6%	-8.7%	70.2%	12.8%	-81.8%	57.8%	6.70%	-88.4%
Average Speed of Answer (Bal. Due) Minutes	26.8	23.2	-13.4%	16.3	93.0	470.6%	30.1	80.6	167.8%
total Individual Returns Received (cum.)							18,302,000	16,035,000	-12.4%
Total Individual Returns Processed (cum.)							17,931,000	13,306,000	-25.8%
Individual Master File (IMF) Pipeline (weekly)							229,470	437,183	90.5%
IMF Error Resolution (weekly)							211,868	621,385	193.3%

Impact of the Shutdown on Taxpayers and Taxpayer Rights

As described above and in the Purple Book legislative recommendation, *Authorize the Office of the Taxpayer Advocate to Assist Certain Taxpayers During a Lapse in Appropriations*, neither the 2018 Non-Filing Season nor the 2019 Filing Season Lapse plans excepted TAS employees for the purpose of fulfilling their statutory mission of helping taxpayers resolve their problems with the IRS.[34] Moreover, no IRS employee was excepted for the purpose of releasing or withdrawing liens, releasing levies, or returning levy proceeds.

Because of Chief Counsel's interpretation of "protecting property" to mean protecting only government property, TAS's work advocating on behalf of taxpayers experiencing refund delays, identity theft, or inappropriate or even unlawful liens and levies was not excepted. Even under the 2019 Filing Season Lapse Plan, in which the IRS would issue refunds—an act that protects *taxpayers'* as opposed to *government* property—TAS was singled out as not being excepted to work with taxpayers experiencing refund delays. This decision was made despite our providing clear evidence of the scope and importance of TAS activity in this area. Below is a list of the highest volume FY 2018 TAS cases that relate to returns processing. These returns show up almost immediately once the filing season opens:

FIGURE 4, FY 2018 TAS Case Receipts[35]

FY 2018 TAS Case Receipts Relating to Return Processing	
Pre-refund Wage Verification	66,048
Identity Theft Victim Assistance	13,787
Processing Amended Returns (1040Xs)	8,767
Unpostable/Rejected Returns (Error Resolution or ERS)	8,673
Taxpayer Protection Program (suspected identity theft returns) Unpostables	7,947
Other Refund Inquiries/Issues	7,628
Processing Original Return Issues	5,312
Returned/Stopped Refunds	3,398
Injured Spouse Claims	3,231
IRS Refund Offset (economic hardship)	2,739
Math Error Issues	1,994

The IRS's authority to collect revenue is not unconditional. It is conditioned on statutory protections, and a lapse in appropriations does not eliminate those protections. It is unconscionable for the government to allow its employees to *enforce* collection of taxes without the concomitant taxpayer rights protections enacted by Congress. Chief among those protections is the Taxpayer Advocate Service, along with statutorily mandated releases of levies where a taxpayer is experiencing economic hardship[36] and withdrawals of notices of federal tax liens which were premature or otherwise not in accordance with administrative procedures, or in the "best interests of the taxpayer (as determined by the National

34 IRC § 7803(c)(2)(A)(i).

35 Taxpayer Advocate Management Information System (TAMIS).

36 IRC § 6343(a)(1)(D).

Taxpayer Advocate) and the United States" or where it furthers the collection of tax or the taxpayer has entered into an installment agreement.[37]

None of these protections is considered an excepted activity, leading to bizarre results. For example, a taxpayer with a levy issued against his or her bank account can normally call ACS and have the levy released by entering into an IA. *Under the 2019 Filing Season Lapse Plan, however, ACS employees can put the taxpayer into an installment agreement, but they cannot release the levy.* Further, if a taxpayer called to say he or she could not afford to pay, the employee might be able to put the taxpayer into Currently Not Collectible status, but still could not release the levy, thereby violating IRC § 6343(a).[38] This is, of course, absurd. And harmful to the taxpayer. And to trust in the tax system and long term voluntary compliance.

Additional evidence of taxpayer harm is shown in Figure 5, which lists the number of IRS notices issued immediately before and during the shutdown, all of which have significant consequences if deadlines are missed. In fact, for a period of time after the United States Tax Court closed on December 25, 2018, the U.S. mail and private delivery services returned petitions to the original sender. Thus, the IRS will not know that the taxpayer timely filed a Tax Court petition protesting the proposed deficiency or the Collection Due Process hearing determination. In the former case, IRS systems will assess the tax and, in both cases, collection will commence, even though under the law all that activity is stayed. Both the Court and the IRS will have to spend extra resources to unwind all this.

And none of this takes into account taxpayer anxiety. Figure 5 shows the volume of certain notices that were issued both before and during the shutdown. These notices – Notice of Levy, Statutory Notice of Deficiency, and Notice of Right to Collection Due Process Hearing, bear statutory deadlines that have serious consequences for the taxpayer if he or she does not take action during that period. When the IRS is shut down, it is impossible for the taxpayer to get the information and assistance needed to move forward. With respect to notices of levy, if the taxpayer cannot contact the IRS and make other payment arrangements within 21 days of the issuance of the levy, the employer or financial institution must pay over the funds to the IRS. The 21-day period for over 18,000 levies expired during the shutdown.[39]

37 IRC § 6323(j)(1)(A)-(D).

38 See *Vinatieri v. Comm'r*, 133 T.C. 392, 400 (Dec. 21, 2009), in which the Tax Court held: "When a taxpayer establishes in a pre-levy collection hearing under section 6330 that the proposed levy would create an economic hardship, it is unreasonable for the settlement officer to determine to proceed with the levy which section 6343(a)(1)(D) would require the IRS to immediately release. Rather than proceed with the levy, the settlement officer should consider alternatives to the levy."

39 Office of Taxpayer Correspondence (Feb. 2019).

FIGURE 5, Selected IRS Correspondence Volumes Where Part of Response Period Occurred During Shutdown and Correspondence Volumes of IRS Correspondence Mailed During Shutdown[40]

Description	Volume of Notices/Letters Issued Prior to Shutdown Where Shutdown Interfered with Response Deadline	Volume of Notices/ Letters Issued During Shutdown Period
Statutory Notices of Deficiency (90 Days to Respond) [a]	527,957	9,267
Notice With CDP Rights (30 Days to Respond) [b]	40,657	13,161
Notice to Provide Information Requested by IRS Exam (30 Days to Respond) [c]	18,492	78
Notice of Levy (21 Days to Respond) – Including Copy Mailed to Taxpayer [d]	18,406	0

a CP3219A and Letter 3219.
b ACS Letter LT11.
c CP75, CP75A, and CP75D.
d Forms 668A, 668W, 8519.

The Way Forward: Digging the IRS Out of this Mess

As officials and pundits are fond of saying, the IRS is the federal agency that touches everyone. While it is true that the IRS is the accounts receivable function of the federal government, this description doesn't quite capture its awesome power to audit and assess taxes, and to seize income and assets, without the need to obtain a judgment. It is also a major disburser of federal benefits and payments. Nearly 112 million individual taxpayers received a refund in 2018, averaging about $2,900.[41] The refundable Earned Income Tax Credit is among the largest federal antipoverty programs, delivering $63 billion for about 25 million taxpayers in 2018.[42] Similarly, nearly $28 billion in Premium Tax Credits helped defray the cost of health insurance for over six million taxpayers.[43]

It is irresponsible for an agency that touches all aspects of people's lives to be underfunded, understaffed, and at the mercy of shutdowns. As we document in these pages, the IRS is wrestling with its workload. With the best of intentions—namely, trying to do its job—it is making strategic decisions that ultimately burden taxpayers, increase its own rework, and create distance and distrust between taxpayers and the tax agency, thereby undermining voluntary compliance. And it is experiencing a "cycle of frustration" as it tries to soldier on with its important work in the midst of shutdowns and funding stops and starts.

There are steps we can take to change this trajectory:

First, the ADA should be amended to provide that where the government takes enforcement action against a taxpayer during a shutdown (or has taken enforcement action just prior to a shutdown), personnel must be excepted to ensure the taxpayer protections and rights enacted by Congress are

40 Office of Taxpayer Correspondence (Feb. 2019). The IRS also mailed 8,807 copies of the Notice of Levy to taxpayers.
41 IRS, Filing Season Statistics (Nov. 2018).
42 IRS, W&I Earned Income Tax Credit (EITC) Fast Facts (last accessed Feb. 2019). Calendar Half Year Report, June 2018. Historically, half year data represents over 95 percent of EITC returns.
43 Information Returns Master File (IRMF) Compliance Data Warehouse (CDW) TY 2017 returns processed in 2018.

available.[44] The ADA was enacted in 1981. At that time, the EITC was only 6 years old, and provided a maximum refundable credit of $500, as opposed to $6,431 for TY 2018.[45] There were no Premium Tax Credits, no American Opportunity Tax Credit, no refundable Child Tax Credit. There are no regulations promulgated under the ADA, and the only legal guidance was issued in 1981 and 1990. Neither of these opinions addresses the role of the IRS in terms of public welfare in the 21st century. We offer a recommendation in the 2019 Purple Book that would address part of this problem.[46]

Second, as discussed above and in more detail later in this report, the IRS should be given additional dedicated, multi-year funding to replace its antiquated core information technology systems, so it can deliver the service and compliance activities that are expected of a 21st century tax administration.[47]

Third, the IRS should invest heavily in improving its communications with taxpayers, especially those notices and letters that have legal significance, such as Notices of Deficiency and Collection Due Process hearing notices. By designing a rights-based notice rather than an enforcement-based notice, the IRS will educate taxpayers and encourage greater engagement, which in turn is likely to improve voluntary compliance.[48]

Fourth, Congress should require the IRS to seriously study and report on the possibility of expanding its withholding system to move closer to a hybrid pay-as-you-earn (PAYE) system. We estimate that in TY 2016, 45 percent of nonitemizing filings reported wage earnings subject to withholding as the sole source of income. Thus, even simple PAYE allows for complete withholding of tax at the source for these approximately 59 million filings. With a variety of withholding adjustments, some involving a greater or lesser degree of difficulty, PAYE tax collection could be extended to seven of the primary income sources, covering 62 percent (91 million) of tax returns.[49] This approach will ease taxpayer and IRS burden alike.

44 See National Taxpayer Advocate 2019 Purple Book (Legislative Recommendation: *Authorize the Office of the Taxpayer Advocate to Assist Certain Taxpayers During a Lapse in Appropriations*) (Dec. 31, 2018).

45 Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit, 1969–99*, Nat'l Tax J. (Dec. 2000).

46 See National Taxpayer Advocate 2019 Purple Book (Legislative Recommendation: *Authorize the Office of the Taxpayer Advocate to Assist Certain Taxpayers During A Lapse in Appropriations*) (Dec. 31, 2018).

47 See Legislative Recommendation: *IT Modernization: Provide the IRS with Additional Dedicated, Multi-Year Funding to Modernize Its Core IT Systems Pursuant to a Plan that Sets Forth Specific Goals and Metrics and Is Evaluated Annually by an Independent Third Party*, *infra*.

48 See Introduction to Notices: *Notices Are Necessary to Inform Taxpayers of Their Rights and Obligations, Yet Many IRS Notices Fail to Adequately Inform Taxpayers, Leading to the Loss of Taxpayer Rights*, *infra*; Most Serious Problem: *Math Error Notices: Although the IRS Has Made Some Improvements, Math Error Notices Continue to Be Unclear and Confusing, Thereby Undermining Taxpayer Rights and Increasing Taxpayer Burden*, *infra*; Most Serious Problem: *Statutory Notices of Deficiency: The IRS Fails to Clearly Convey Critical Information in Statutory Notices of Deficiency, Making it Difficult for Taxpayers to Understand and Exercise Their Rights, Thereby Diminishing Customer Service Quality, Eroding Voluntary Compliance, and Impeding Case Resolution*, *infra*; Most Serious Problem: *Collection Due Process Notices: Despite Recent Changes to Collection Due Process Notices, Taxpayers Are Still at Risk for Not Understanding Important Procedures and Deadlines, Thereby Missing Their Right to an Independent Hearing and Tax Court Review*, *infra*; and Literature Review: *Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights*, *infra*.

49 These seven income types are wages, interest, pensions, dividends, capital gains, Individual Retirement Account (IRA) income, and unemployment. Study: *A Conceptual Analysis of Pay-As-You-Earn (PAYE) Withholding Systems as a Mechanism for Simplifying and Improving U.S. Tax Administration*, *infra*.

Fifth, the IRS should re-examine how it measures its performance in all its activities—outreach and education, audits, collection—and regularly assess whether its initiatives increase future voluntary compliance or undermine it.[50]

With these five steps, the IRS will have the tools to deliver a robust and useful online accounts while providing meaningful person-to-person assistance to taxpayers via phone, virtual conferences, or in-person. It will have the research to allow it to select appropriate returns for a repertoire of compliance touches and will not waste significant resources on no change audits. It will be able to approach all its compliance touches as an opportunity to educate and gain trust with the taxpayer, because it will be utilizing data and research to understand the causes of noncompliance. And where enforcement action is required, taxpayers will have confidence that IRS employees understand and respect the significant protections afforded by the IRC, including the Taxpayer Bill of Rights.[51]

It is true that taxes are the "lifeblood of government," but as I've written elsewhere, it is the taxpayers of the United States who pay that lifeblood.[52] We need to honor our taxpayers by providing them the best tax administration possible. The report that follows includes our recommendations to improve the taxpayer's journey through the tax system as well as improve the effectiveness and efficiency of the IRS.

Respectfully Submitted,

Nina E. Olson
National Taxpayer Advocate
12 February 2019

50 See Taxpayer Rights Assessment: *IRS Performance Measures and Data Relating to Taxpayer Rights*, *infra*; Most Serious Problem: *Tax Law Questions: The IRS's Failure to Answer the Right Tax Law Questions at the Right Time Harms Taxpayers, Erodes Taxpayer Rights, and Undermines Confidence in the IRS*, *infra*; Most Serious Problem: *Navigating The IRS: Taxpayers Have Difficulty Navigating the IRS, Reaching the Right Personnel to Resolve Their Tax Issues, and Holding IRS Employees Accountable*, *infra*; Most Serious Problem: *Correspondence Examination: The IRS's Correspondence Examination Procedures Burden Taxpayers and are not Effective in Educating the Taxpayer and Promoting Future Voluntary Compliance*, *infra*; Most Serious Problem: *Field Examination: The IRS's Field Examination Program Burdens Taxpayers and Yields High No-Change Rates, Which Waste IRS Resources and May Discourage Voluntary Compliance*, *infra*; Most Serious Problem: *Field Collection: The IRS Field Collection Function Is Not Appropriately Staffed or Trained to Minimize Taxpayer Burden and Ensure Taxpayer Rights Are Protected*, *infra*.

51 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR that was adopted by the IRS are now codified in the IRC.

52 Nina E. Olson, *Taking the Bull by its Horns: Some Thoughts on Constitutional Due Process in Tax Collection*, 2010 Erwin N. Griswold Lecture Before the American College of Tax Counsel, 63 Tax Law. 227, 234 (2010).

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

In the 2013 Annual Report to Congress, the National Taxpayer Advocate proposed a "report card" of measures that "…provide a good indication whether the IRS is treating U.S. taxpayers well and furthering voluntary compliance."[1]

In 2014, the IRS officially adopted the Taxpayer Bill of Rights (TBOR) which is a list of ten rights that the National Taxpayer Advocate recommended to help taxpayers and IRS employees alike gain a better understanding of the dozens of discrete taxpayer rights scattered throughout the multi-million word Internal Revenue Code (IRC).[2] In late 2015, Congress followed suit by adding the list of fundamental rights to the IRC.[3] While listing these rights in IRC § 7803(a)(3) is a significant achievement for increasing taxpayers' awareness of their rights, the process of integrating taxpayer rights into all aspects of tax administration continues. The *Taxpayer Rights Assessment* contains selected performance measures and data organized by the ten taxpayer rights and is one step toward integrating taxpayer rights into tax administration.

This *Taxpayer Rights Assessment* is a work in progress. The following data provide insights into IRS performance; however, they are by no means comprehensive. In some instances, data is not readily available. In other instances we may not yet have sufficient measures in place to address specific taxpayer rights. And, despite what the numbers may show, we must be concerned for those taxpayers who still lack access to services and quality service even when performance metrics are increasing. This *Taxpayer Rights Assessment* will grow and evolve over time as data becomes available and new concerns emerge.

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

Measure/Indicator	Fiscal Year (FY) 2016	FY 2017	FY 2018
Individual Correspondence Volume (adjustments) [a]	4,817,708	4,598,654	4,485,906
Average cycle time to work Individual Master File (IMF) Correspondence [b]	84 days	69 days	66 days
Inventory Overage [c]	49.1%	39.5%	37.9%
Business Correspondence Volume (adjustments) [d]	2,940,925	2,736,451	2,595,131
Average cycle time to work Business Master File (BMF) Correspondence [e]	47 days	45 days	51 days
Inventory Overage [f]	8.6%	11.7%	23.5%
Total Correspondence (all types)	TBD	TBD	TBD
Quality of IRS Forms & Publications	TBD	TBD	TBD
IRS.gov Web Page Ease of Use	TBD	TBD	TBD
IRS Outreach	TBD	TBD	TBD

a IRS, Joint Operations Center (JOC), *Adjustments Inventory Reports: July-September Fiscal Year (FY) Comparison* (FY 2017 and FY 2018). This correspondence data is also repeated under Right 4 – *The Right to Challenge the IRS's Position and Be Heard*.
b IRS, Research Analysis and Data (RAD), *Accounts Management Reports: Collection Information System (CIS) Closed Case Cycle Time* (FY 2017 and FY 2018).
c IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2017 and FY 2018* (weeks ending Sept. 30, 2017 and Sept. 29, 2018).
d IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2017 and FY 2018).
e IRS, RAD, *Accounts Management Reports: CIS Closed Case Cycle Time* (FY 2017 and FY 2018).
f IRS, *Weekly Enterprise Adjustments Inventory Report, FY 2017 and FY 2018* (weeks ending Sept. 30, 2017 and Sept. 29, 2018).

1 *See* National Taxpayer Advocate 2013 Annual Report to Congress xvii-xviii (Preface: *Taxpayer Service Is Not an Isolated Function but Must Be Incorporated throughout All IRS Activities, Including Enforcement*).
2 *See* Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR that were adopted by the IRS are now codified in the Internal Revenue Code (IRC). *See* IRC § 7803(a)(3).
3 *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

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

Measure/Indicator	FY 2016	FY 2017	FY 2018
Number of Returns Filed (projected, all types) [a]	246,945,921	247,807,099	250,470,800
Total Individual Income Tax Returns [b]	150,711,378	150,786,286	152,106,500
E-file Receipts, calendar year (Received by 12/02/16, 12/01/17, 11/23/18) [c]	131,851,000	132,319,000	135,459,000
E-file Receipts: Tax Professional (calendar year) [d]	60%	60%	59%
E-file Receipts: Self Prepared (calendar year) [e]	40%	40%	41%
Returns Prepared by:			
VITA / TCE / AARP (tax year) [f]	3,542,336	3,402,019	3,270,848
Free File Consortium (tax year) [g]	2,356,167	2,352,555	2,486,120
Fillable Forms (tax year) [h]	346,098	325,482	317,527
Number of Taxpayer Assistance ("Walk-In") Centers (TAC) [i]	376	371	359
Number of TAC Contacts [j]	4.5 million	3.3 million	2.9 million
Total Calls to IRS [k]	117,479,981	95,618,714	98,532,231
Number of Attempted Calls to IRS Customer Service Lines [l]	104,275,387	74,471,676	77,715,282
Toll Free: Percentage of calls answered [Level of Service (LOS)] [m]	53.4%	77.1%	75.9%
Toll Free: Average Speed of Answer [n]	17.8 minutes	8.4 minutes	7.5 minutes
NTA Toll Free: Percentage of calls answered (LOS) [o]	58.1%	76.7%	78.4%
NTA Toll Free: Average Speed of Answer [p]	8.9 minutes	2.9 minutes	3.2 minutes
Practitioner Priority: Percentage of calls answered (LOS) [q]	71.0%	81.9%	84.9%
Practitioner Priority: Average Speed of Answer [r]	10.5 minutes	8.9 minutes	7.5 minutes
Tax Exempt/Government Entities: Percentage of calls answered (LOS) [s]	56.8%	69.5%	69.2%
Tax Exempt/Government Entities: Average Speed of Answer [t]	15.9 minutes	9.2 minutes	8.8 minutes
Toll Free Customer Satisfaction [u]	88.0%	90.0%	90.0%
Awareness of Service (or utilization)	TBD	TBD	TBD
IRS Issue Resolution – Percentage of taxpayers who had their issue resolved as a result of the service they received	TBD	TBD	TBD
Taxpayer Issue Resolution – Percentage of taxpayers who reported their issue was resolved after receiving service	TBD	TBD	TBD

a IRS Pub. 6292, *Fiscal Year Return Projections for the United States 2017-2024* 3 (Sept. 2017); IRS Pub. 6292, *Fiscal Year Return Projections for the United States: 2018-2025* 3 (June 2018). The FY 2017 figure has been updated from what we reported in the 2017 Annual Report to Congress to report actual return counts. The FY 2018 figures are projected numbers. The number of returns and related metrics are proxies for IRS workload and provide context for the environment in which taxpayers seek Quality Service and other rights.

b IRS Pub. 6292, *Fiscal Year Return Projections for the United States: 2017-2024* 3 (Sept. 2017); IRS Pub. 6292, *Fiscal Year Return Projections for the United States: 2018-2025* 3 (June 2018). The FY 2017 figure has been updated from what we reported in the 2017 Annual Report to Congress to report actual return counts. The FY 2018 figures are projected numbers.

c IRS, *E-File Reports*, http://efile.enterprise.irs.gov/Progress.asp (last visited Dec. 7, 2018). Rounded to the nearest thousand.

d *Id.* (last visited Dec. 9, 2018).

e *Id.*

f Free, in-person return preparation is offered to low income and older taxpayers by non-IRS organizations through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE), and American Association of Retired Persons (AARP) Tax-Aide programs. IRS, Compliance Data Warehouse (CDW), Individual Returns Transaction File. The FY 2016 figures have been updated from what we reported in the 2016 Annual Report to Congress. The FY 2016 figures represent tax year 2015 tax returns. The FY 2017 figures represent tax year 2016 tax returns. The FY 2018 figures represent tax year 2017 tax returns.

g IRS, CDW, Electronic Tax Administration Marketing Database. The FY 2016 figures represent tax year 2015 tax returns. The FY 2017 figures represent tax year 2016 tax returns. The FY 2018 figures represent tax year 2017 tax returns.

h *Id.* The FY 2016 figures have been updated from what we reported in the 2016 Annual Report to Congress. The FY 2016 figures represent tax year 2015 returns. The FY 2017 figures represent tax year 2016 tax returns. The FY 2018 figures represent tax year 2017 tax returns.

i FY 2016 figures from IRS response to TAS fact check (Dec. 20, 2016). FY 2017 figures from IRS response to TAS information request (Nov. 3, 2017). FY 2018 figures from IRS response to TAS information request (Oct. 24, 2018). The FY 2018 figure was calculated as of August 2018, and does not include 38 face-to-face Virtual Service Delivery sites located at community partner facilities.

(Continued from previous page.)

j Wage and Investment Division (W&I), Business Performance Review (BPR), 4th Quarter, FY 2018 12 (Nov. 8, 2018).
k IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (weeks ending Sept. 30, 2017 and Sept. 30, 2018; reports generated Oct. 19, 2018).
l *Id*. Number of calls to Accounts Management (formerly Customer Services) is the sum of 29 lines (0217, 1040, 4933, 1954, 0115, 8374, 0922, 0582, 5227, 9887, 9982, 4184, 7388, 0452, 0352, 7451, 9946, 5215, 3536, 2050, 4017, 2060, 4778, 4259, 8482, 8775, 5500, 4490, and 5640). The FY 2018 figure includes the sum of a 30th line (5245).
m IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (weeks ending Sept. 30, 2016 and Sept. 30, 2017; reports generated Oct. 19, 2018). Accounts Management calls answered include reaching live assistor or selecting options to hear automated information messages.
n IRS, JOC, *Snapshot Reports: Enterprise Snapshot* (weeks ending Sept. 30, 2017 and Sept. 30, 2018; reports generated Oct. 19, 2018).
o IRS, JOC, *Snapshot Reports: Product Line Detail* (weeks ending Sept. 30, 2017 and Sept. 30, 2018; reports generated Oct. 19, 2018).
p *Id*.
q *Id*.
r *Id*.
s *Id*.
t *Id*.
u W&I, *FY 2018 W&I Customer Satisfaction – Dissatisfaction Report* (2018).

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

Measure/Indicator	FY 2016	FY 2017	FY 2018
Toll-Free Tax Law Accuracy [a]	96.4%	96.7%	95.5%
Toll-Free Accounts Accuracy [b]	96.1%	96.0%	96.1%
Scope of Tax Law Questions Answered	TBD	TBD	TBD
Correspondence Examinations – Individual Tax Returns			
No change rate [c]	16.2%	14.7%	12.6%
Agreed rate [d]	20.6%	22.4%	23.4%
Non-response rate [e]	42.1%	40.6%	41.2%
Percentage of cases appealed	TBD	TBD	TBD
Field Examinations – Individual Tax Returns			
No change rate [f]	14.6%	14.3%	13.3%
Agreed rate [g]	45.4%	46.1%	48.4%
Non-response rate [h]	0.3%	0.3%	0.7%
Percentage of cases appealed	TBD	TBD	TBD
Office Examinations – Individual Tax Returns			
No change rate [i]	12.2%	14.4%	12.2%
Agreed rate [j]	43.4%	42.8%	44.1%
Non-response rate [k]	20.6%	19.0%	18.3%
Percentage of cases appealed	TBD	TBD	TBD
Math Error Adjustments	TBD	TBD	TBD
Math Error Abatements	TBD	TBD	TBD
Number of Statutory Notices of Deficiency Issued	TBD	TBD	TBD
Number of Statutory Notices of Deficiency Appealed	TBD	TBD	TBD
Number of Collection Appeals Program Conferences	TBD	TBD	TBD
Number of Collection Appeals Program Conferences Reversing IRS position	TBD	TBD	TBD
Number of Collection Due Process Conferences	TBD	TBD	TBD
Number of Collection Due Process Conferences Reversing IRS position	TBD	TBD	TBD

a W&I, BPR, 4th Quarter, FY 2018 10 (Nov. 8, 2018).
b *Id*.
c IRS, CDW, Audit Information Management System (AIMS), Closed Case Database. Internal Revenue Manual (IRM) 4.4.12.5.49.1 (June 1, 2002) defines a no change as case closed by the examiner with no additional tax due (disposal code 1 and 2).

(Continued from previous page.)

d IRS, CDW, Audit Information Management System, Closed Case Database. IRM 4.4.12.5.22.2 (June 1, 2002) defines an agreed case as disposal code 3, 4, 8, or 9.
e IRS, CDW, AIMS, Closed Case Database.
f *Id*.
g *Id*.
h *Id*.
i *Id*.
j *Id*.
k *Id*.

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

Measure/Indicator	FY 2016	FY 2017	FY 2018
Individual Correspondence Volume (adjustments) [a]	4,817,708	4,598,654	4,485,906
Average cycle time to work IMF Correspondence [b]	84 days	69 days	66 days
Inventory Overage [c]	49.1%	39.5%	37.9%
Business Correspondence Volume [d]	2,940,925	2,736,451	2,595,131
Average cycle time to work BMF Correspondence [e]	47 days	45 days	51 days
Inventory Overage [f]	8.6%	11.7%	23.5%
Percentage of Math Error Adjustments Abated	TBD	TBD	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD	TBD	TBD
Number of Collection Appeal Program (CAP) Conferences Requested by Taxpayers [g]	TBD	TBD	TBD
Percentage of CAP Conferences that Reversed the IRS Position	TBD	TBD	TBD
Number of Collection Due Process Hearings Requested by Taxpayers [h]	TBD	TBD	TBD
Percentage of Collection Due Process Hearings that Reversed the IRS Position	TBD	TBD	TBD

a IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2017 and FY 2018).
b IRS, RAD, *Accounts Management Reports: CIS Closed Case Cycle Time* (FY 2017 and FY 2018).
c IRS, *Weekly Enterprise Adjustments Inventory Report*, FY 2017 and FY 2018 (weeks ending Sept. 30, 2017 and Sept. 29, 2018).
d IRS, JOC, *Adjustments Inventory Reports: July-September Fiscal Year Comparison* (FY 2017 and FY 2018).
e IRS, RAD, *Accounts Management Reports: CIS Closed Case Cycle Time* (FY 2017 and FY 2018).
f IRS, *Weekly Enterprise Adjustments Inventory Report*, FY 2017 and FY 2018 (weeks ending Sept. 30, 2017 and Sept. 29, 2018).
g Taxpayers may request a Collection Appeals Process review as the result of IRS actions such filing a Notice of Federal Tax Lien, an IRS levy or seizure of property, and termination, rejection, or modification of an installment agreement. *See* IRS Pub. 1660, *Collection Appeal Rights*.
h Taxpayers may request a Collection Due Process review when the IRS plans to take actions such as filing a federal tax lien or levy. *See* IRS Pub. 1660, *Collection Appeal Rights*.

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

Measure/Indicator	FY 2016	FY 2017	FY 2018
Number of Cases Appealed [a]	114,362	103,574	103,359
Appeals Staffing (On-rolls) [b]	1,449	1,345	1,207
Number of States without an Appeals or Settlement Officer [c]	11	11	11
Customer Satisfaction of Service in Appeals [d]	67%	68%	N/A
Average Days in Appeals to Resolution	TBD	TBD	TBD
Percentage of Statutory Notices of Deficiency Appealed to Tax Court	TBD	TBD	TBD

a Office of Appeals, BPR, 3rd Quarter, FY 2018 9 (Aug. 23, 2018). The FY 2018 number is a projected figure. The Appeals FY 2018 4th Quarter BPR was not available at time of print.
b For FY 2016 and FY 2017, Office of Appeals, BPR, 3rd Quarter, FY 2018 12 (Aug. 23, 2018). The Appeals FY 2018 4th Quarter BPR was not available at time of print. For FY 2018, IRS, Human Resources Reporting Center, https://persinfo.web.irs.gov/track/workorg.asp, IRS Staffing by Business Unit for week ending Sept. 29, 2018.
c For FY 2016 and FY 2017, IRS, Human Resources Reporting Center, https://persinfo.web.irs.gov/posrpt.htm. For FY 2016 and FY 2017, Employee Position (OF8) Listing for weeks ending Oct. 1, 2016 and Sept. 30, 2017. For FY 2018, IRS response to TAS fact check (Nov. 21, 2018). The FY 2016 figure has been updated from what we reported in the 2016 Annual Report to Congress. The IRS also has Appeals and Settlement Officers in the District of Columbia which are not included in this figure.
d Office of Appeals, BPR, 3rd Quarter, FY 2018 9 (Aug. 23, 2018). The Appeals FY 2018 4th Quarter BPR was not available at time of print.

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

Measure/Indicator	FY 2016	FY 2017	FY 2018
Average Days to Complete Correspondence Examination (non-EITC) [a]	199 days	207 days	236 days
Average Days to Complete Correspondence Examination (EITC) [b]	219 days	222 days	240 days
Average Days to Reach Determination on Applications for Exempt Status [c]	54 days	54 days	69 days
Average Days for Exempt Organization Function to Respond to Correspondence [d]	45 days	27 days	46 days

a W&I, BPR, 4th Quarter, FY 2018 14 (Nov. 8, 2018). The FY 2016 and FY 2017 figures have been updated from what we reported in the 2017 Annual Report to Congress.
b *Id*.
c For FY 2016 and FY 2017, Tax Exempt & Government Entities (TE/GE), BPR, 4th Quarter, FY 2017 9 (Nov. 30, 2017). For FY 2018, TE/GE, Compliance, Planning & Classification email to TAS (Dec. 13, 2018).
d *Id*.

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

Measure/Indicator	FY 2016	FY 2017	FY 2018
Number (or percentage) of Collection Due Process cases where IRS cited for Abuse of Discretion	TBD	TBD	TBD
Number of Offers in Compromise Submitted using 'Effective Tax Administration' as Basis	TBD	TBD	TBD
Percentage of Offers in Compromise Accepted that used 'Effective Tax Administration' as Basis	TBD	TBD	TBD
Number of cases where taxpayer received repayment of attorney fees as result of final judgment	TBD	TBD	TBD

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

Measure/Indicator	FY 2016	FY 2017	FY 2018
Number of Closed Unauthorized Access of Taxpayer Account (UNAX) Investigations [a]	147	151	198
UNAX Investigations Resulting in Prosecution, Removal, Resignation or Suspension of Employee [b]	38	64	78
UNAX Investigations Resulting in other Administrative Dispositions [c]	81	74	105
UNAX Investigations Where Employee Cleared of Wrongdoing [d]	28	13	15

a IRS, Automated Labor and Employee Relations Tracking System (ALERTS). The number of IRS employees averaged 85,002 in FY 2016, 83,775 in FY 2017, and 80,836 in FY 2018. IRS, Human Resources Reporting Center, *Fiscal Year Population Report*.
b IRS, ALERTS.
c *Id*. Administrative dispositions includes alternative discipline in lieu of suspension; case cancelled or merged with another case; caution letter; last chance agreement; oral counseling; reprimand; written counseling; etc.
d *Id*.

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

Measure/Indicator	FY 2016	FY 2017	FY 2018
Percentage of Power of Attorney Requests Overage (as of 10/1/16, 9/30/17, 9/29/2018) [a]	0%	18.2%	0%
Number of Low Income Taxpayer Clinics Funded (calendar year) [b]	138	138	134
Funds Appropriated for Low Income Taxpayer Clinics [c]	$12.0 million	$12.0 million	$12.0 million
Number of States with a Low Income Taxpayer Clinic (calendar year) [d]	49	49	48
Number of Low Income Taxpayer Clinic Volunteer Hours (calendar year) [e]	60,669	47,480	57,914

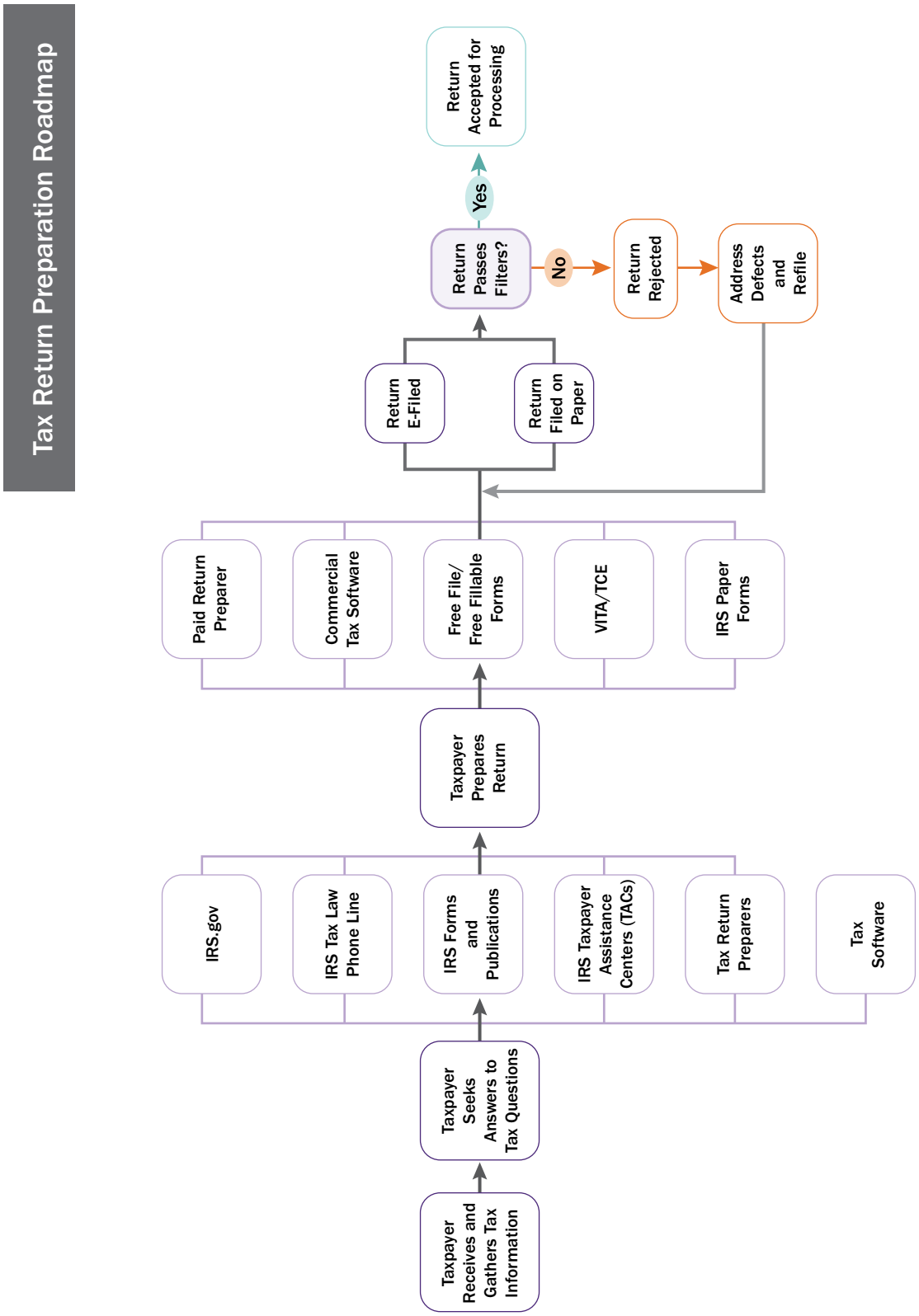
a IRS, JOC, *Customer Account Services, Accounts Management Paper Inventory Reports* (weeks ending Oct. 1, 2016, Sept. 30, 2017, and Sept. 29, 2018).
b IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Jan. 2017, Feb. 2018, and Dec. 2018).
c Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, enacted Dec. 18, 2015. Consolidated Appropriations Act, 2017, Pub. L. No. 115-31, enacted May 5, 2017. Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, enacted Mar. 23, 2018. The amounts actually awarded to Low Income Taxpayer Clinics (LITCs) differed from the appropriated amounts. The amount awarded to clinics in FY 2016 was over $11.4 million based on the number of available grantees who met the requirements and were selected for funding. The amount awarded to clinics in FY 2017 was approximately $11.8 million based on the number of available grantees who met the requirements and were selected for funding. The amount awarded to clinics in FY 2018 was over $11.8 million based on the number of available grantees who met the requirements and were selected for funding. The FY 2016 figures have been updated from what we reported in the 2016 Annual Report to Congress.
d IRS Pub. 5066, *Low Income Tax Clinics Program Report* (Jan. 2017, Feb. 2018, and Dec. 2018). For calendar year (CY) 2018, forty-eight states and the District of Columbia had at least one LITC. As of the start of the 2018 calendar year there was no LITC in Hawaii or North Dakota.
e *Id*. The FY 2016 number (60,669) was confirmed by the LITC Program Director (Oct. 28, 2016). The FY 2016 Pub. 5066 reported a rounded number (60,000). The FY 2016 figure reflects volunteer hours from CY 2015. The FY 2017 figure reflects volunteer hours from CY 2016. The FY 2018 figure reflects volunteer hours from CY 2017.

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

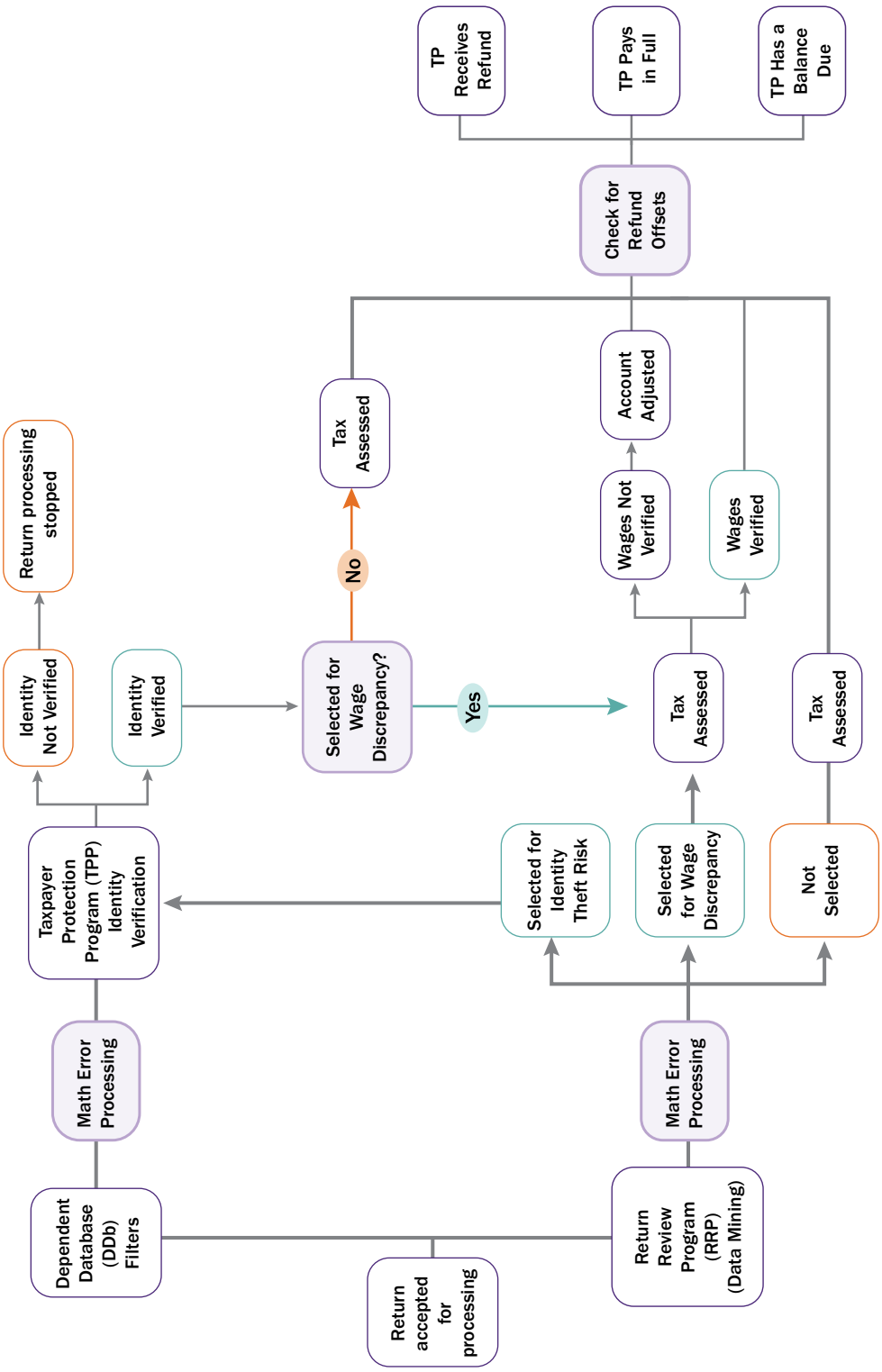
Measure/Indicator	FY 2016	FY 2017	FY 2018
Offer in Compromise (OIC): Number of Offers Submitted [a]	64,479	62,243	59,127
OIC: Percentage of Offers Accepted [b]	42.5%	38.1%	37.8%
Installment Agreements (IA): Number of Individual & Business IAs [c]	3,115,404	2,924,780	2,883,035
Streamlined Installment Agreements Number of Individual & Business IAs [d]	2,630,811	2,236,434	2,079,743
Installment Agreements Collection Field Function (CFf): Number of Individual & Business IAs [e]	42,978	35,449	39,178
Streamlined Installment Agreements (CFf): Number of Individual & Business IAs [f]	8,477	6,936	5,224
Number of OICs Accepted per Revenue Officer [g]	7.7	7.6	9.1
Number of IAs Accepted per Revenue Officer [h]	12.0	10.6	14.8
Percentage of Cases in the Queue (Taxpayers) [i]	15.5%	13.9%	16.6%
Percentage of Cases in the Queue (Modules) [j]	23.9%	21.8%	24.6%
Percentage of Taxpayer Delinquent Accounts (TDAs) reported Currently Not Collectible – Surveyed (shelved) [k]	16.9%	32.3%	75.6%
Age of Delinquencies in the Queue [l]	4.5 years	4.5 years	4.8 years
Percentage of Modules in Queue prior to three tax years ago [m]	78.7%	78.2%	79.6%
Percentage of cases where the taxpayer is fully compliant after five years [n]	48%	47%	51%

a IRS, Collection Activity Report No. 5000-108, FY 2016 (Oct. 7, 2016), FY 2017 (Oct. 2, 2017), and FY 2018 (Oct. 1, 2018).
b *Id*.
c IRS, Collection Activity Report No. 5000-6, FY 2016 (Oct. 3, 2016), FY 2017 (Oct. 1, 2017), and FY 2018 (Sept. 30, 2018).
d *Id*.
e *Id*.
f *Id*.
g *Id*. *See also* IRS Human Resources Reporting Center – number of revenue officers in Small Business/Self-Employed as of the end of FY 2016, FY 2017, and FY 2018 (pay period 19).
h *Id*.
i IRS, Collection Activity Report No. 5000-2, FY 2016 (Oct. 3, 2016), FY 2017 (Oct. 1, 2017), and FY 2018 (Sept. 30, 2018).
j *Id*.
k *Id*. Beginning in FY 2017, the IRS shelves cases prior to potential transfer for the Private Collection Initiative. Row title has been updated to clarify the data points.
l Accounts Receivable Dollar Inventory. Age of cases in the collection queue as of cycle 37 of 2016, and 2017, and 2018.
m IRS, Collection Activity Report No. 5000-2, FY 2016 (Oct. 3, 2016), FY 2017 (Oct. 1, 2017), and FY 2018 (Sept. 30, 2018).
n Calculation by TAS Research. Percentage of taxpayers with tax delinquent accounts in 2011, 2012, and 2013, respectively, and who have no new delinquencies five years later. The FY 2017 figure has been updated from what we reported in the 2017 Annual Report Congress. IRS, CDW, Individual Master File (IMF).

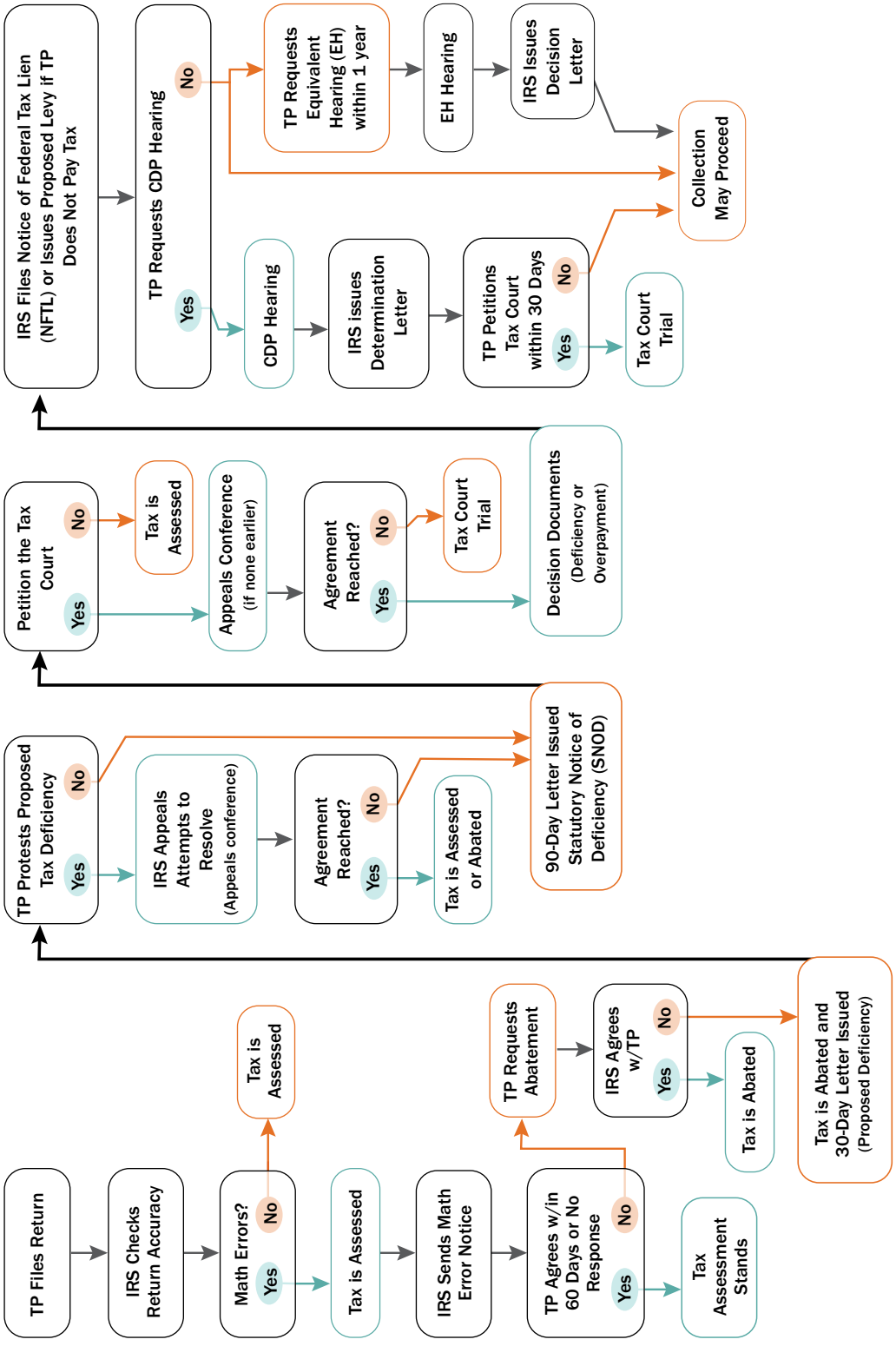
THE TAXPAYER'S JOURNEY: Roadmaps Reflecting the Taxpayer's Path through the Tax System



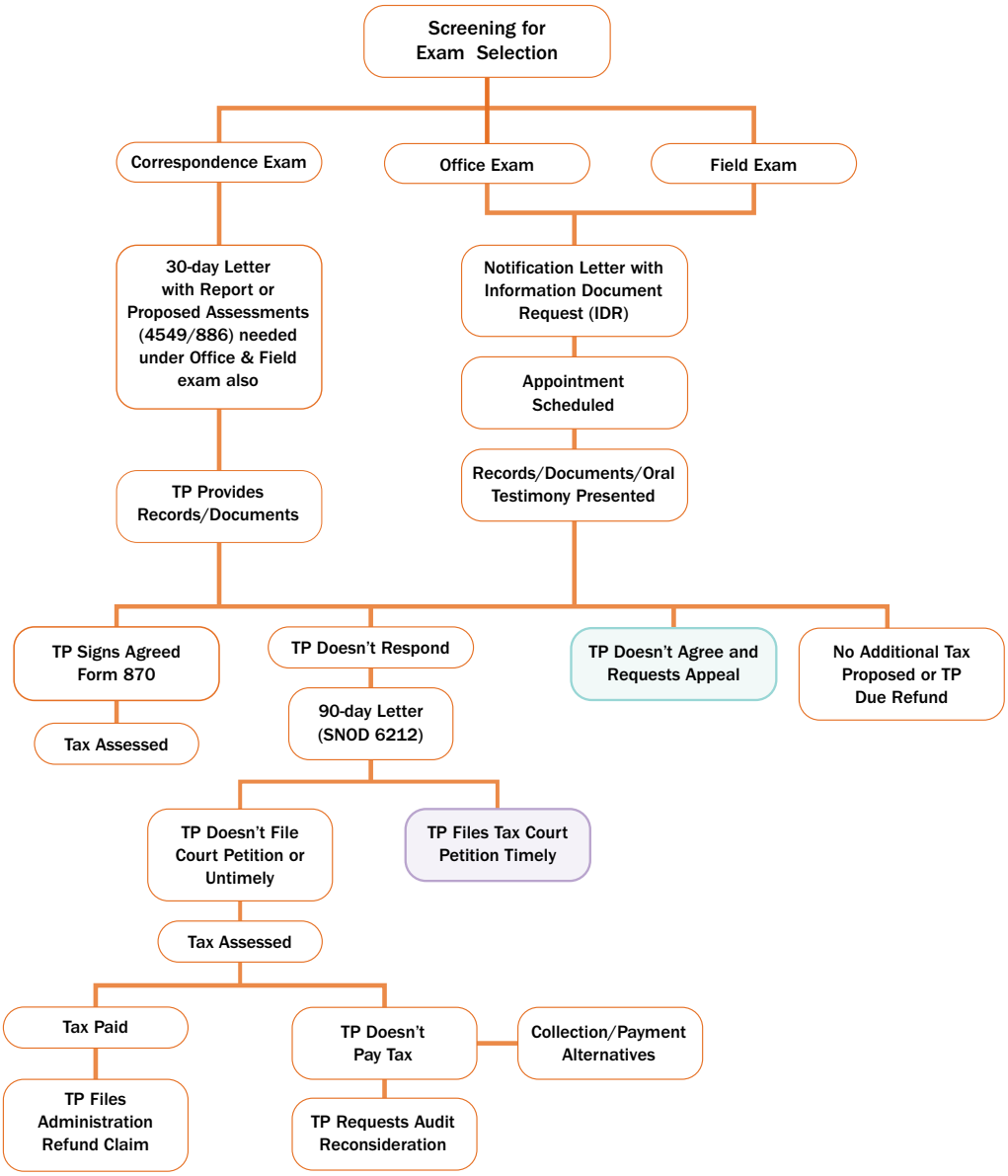
Tax Return Processing Roadmap



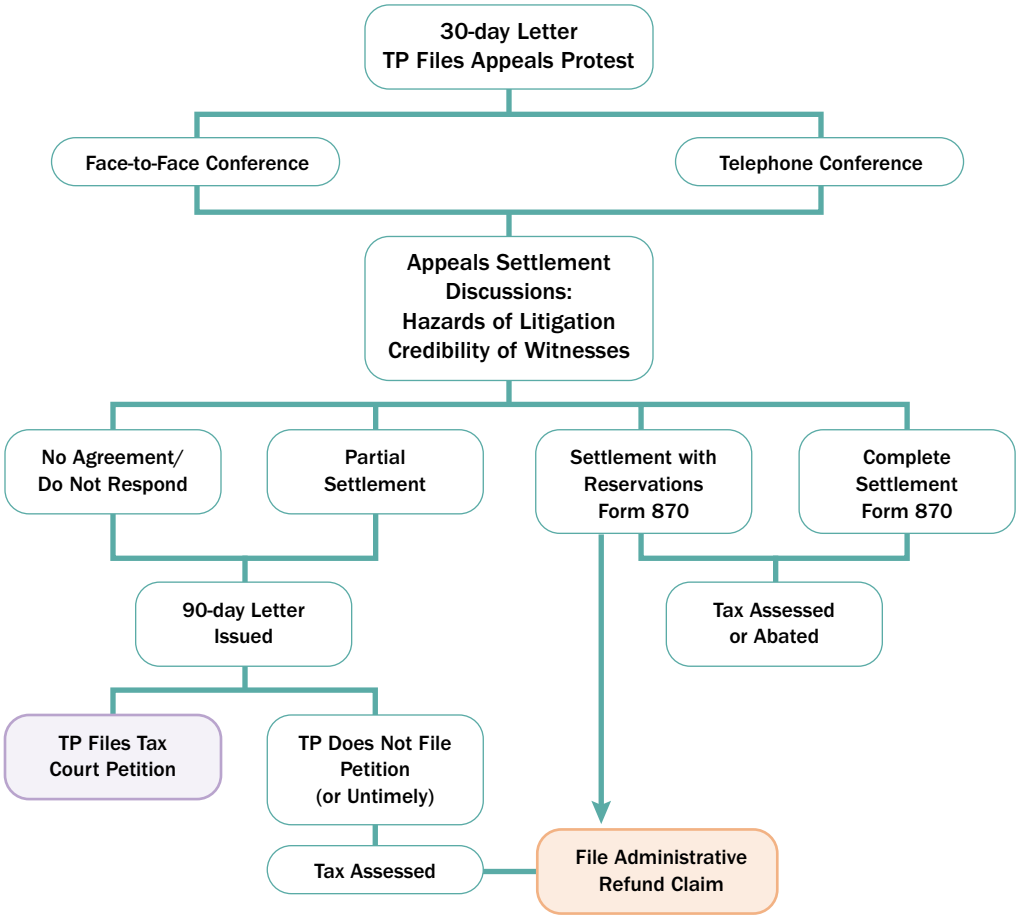
Notices Roadmap

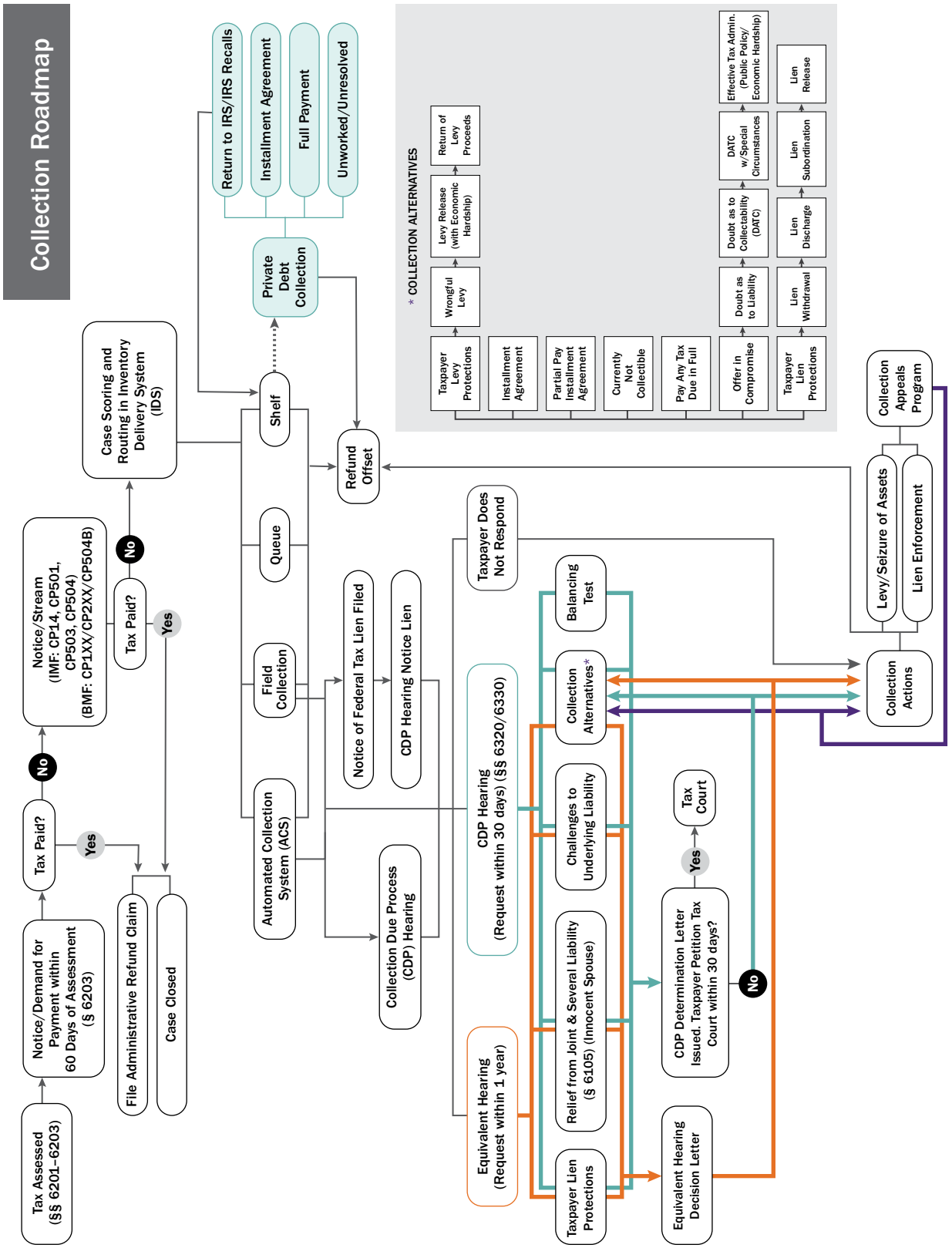


Exam Roadmap

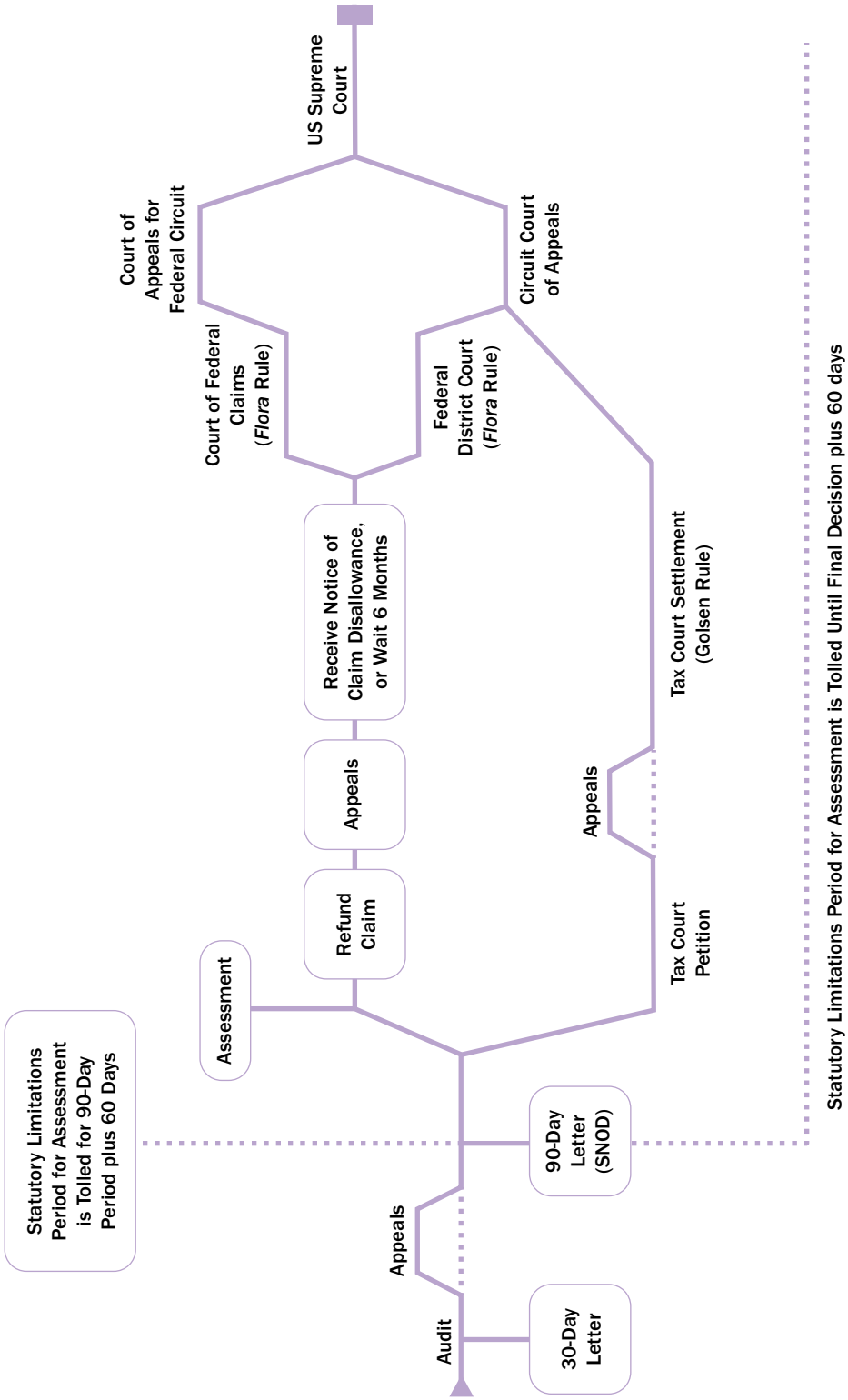


Appeals Roadmap




Collection Roadmap
Tax Assessed (§§ 6201–6203)
Notice/Demand for Payment within 60 Days of Assessment (§ 6203)
Tax Paid?
No
Yes
Notice/Stream (IMF: CP14, CP501, CP503, CP504) (BMF: CP1XX/CP2XX/CP504B)
Tax Paid?
No
Yes
File Administrative Refund Claim
Case Closed
Case Scoring and Routing in Inventory Delivery System (IDS)
Shelf
Queue
Field Collection
Automated Collection System (ACS)
Private Debt Collection
Return to IRS/IRS Recalls
Installment Agreement
Full Payment
Unworked/Unresolved
Refund Offset
Notice of Federal Tax Lien Filed
CDP Hearing Notice Lien
Collection Due Process (CDP) Hearing
Taxpayer Does Not Respond
CDP Hearing (Request within 30 days) (§§ 6320/6330)
Equivalent Hearing (Request within 1 year)
Balancing Test
Collection Alternatives*
Challenges to Underlying Liability
Relief from Joint & Several Liability (§ 6105) (Innocent Spouse)
Taxpayer Lien Protections
Tax Court
Yes
CDP Determination Letter Issued. Taxpayer Petition Tax Court within 30 days?
No
Equivalent Hearing Decision Letter
Collection Actions
Levy/Seizure of Assets
Lien Enforcement
Collection Appeals Program
* COLLECTION ALTERNATIVES
Taxpayer Levy Protections
Wrongful Levy
Levy Release (with Economic Hardship)
Return of Levy Proceeds
Installment Agreement
Partial Pay Installment Agreement
Currently Not Collectible
Pay Any Tax Due in Full
Offer in Compromise
Doubt as to Liability
Doubt as to Collectability (DATC)
DATC w/Special Circumstances
Effective Tax Admin. (Public Policy/ Economic Hardship)
Taxpayer Lien Protections
Lien Withdrawal
Lien Discharge
Lien Subordination
Lien Release

Litigation Roadmap



THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to prepare an Annual Report to Congress that contains a summary of at least 20 of the most serious problems encountered by taxpayers each year. For 2018, the National Taxpayer Advocate has identified, analyzed, and offered recommendations to assist the IRS and Congress in resolving 20 such problems.

THE PREFILING STAGE

MSP #1 TAX LAW QUESTIONS: The IRS's Failure to Answer the Right Tax Law Questions at the Right Time Harms Taxpayers, Erodes Taxpayer Rights, and Undermines Confidence in the IRS

Problem

In 2014, the IRS implemented a policy to only answer tax law questions during the filing season, roughly from January through mid-April of any year. It justified this abrupt change in policy as a cost-savings effort in a time of budget constraints. This change does not comport with an agency charged with administering the tax law and focused on the customer experience.

Taxpayers have ever-changing tax situations year-round. People move, open a business, close a business, get married, get divorced, have children, and experience many other life changes that affect their tax obligations. Forcing taxpayers into a 3.5-month window to ask questions or making it necessary for them to seek advice from a third-party source can be frustrating and costly to the taxpayer and result in eroded trust and confidence in the IRS.

Analysis

The IRS designates certain tax law topics as out-of-scope, meaning it does not provide answers to taxpayers who call or visit the IRS inquiring about those issues. The IRS does not track what taxpayers ask about if the topic is out-of-scope. Failing to do so limits the ability of the IRS to determine if there is sufficient demand for information about a topic to consider declaring the topic in-scope. Providing taxpayers timely and accurate answers to their tax law questions is crucial to helping taxpayers understand and meet their tax obligations and is fundamental to the *right to be informed*. If a taxpayer cannot find answers from the IRS, it undermines all taxpayer rights. Testing by TAS in spring and fall of 2018 revealed inconsistent service by the IRS in answering tax law questions on the phone. Despite assurances from the IRS that it would answer Tax Cuts and Jobs Act questions year-round, TAS test calls revealed that employees were not able to answer even basic questions about the new tax law. The IRS has many tools available to meet the needs of taxpayers and ensure that taxpayers can find the assistance they need promptly. By meeting taxpayers where they are, whether on the phone or online, more taxpayers will be able to get answers to their tax law questions.

Recommendations

The National Taxpayer Advocate recommends that the IRS answer in-scope tax law questions year-round; deem all questions related to the new tax law as in-scope for a reasonable period of at least two years and evaluate taxpayer demand prior to declaring topics out of scope; track calls and contacts about out-of-scope topics and develop Individual Tax Law Assistant scripts for frequently asked questions or consider declaring topics in-scope; and develop a method to respond to uncommon or complex questions (*i.e.*, those that are out-of-scope for the phones and TACs) via email or call back to the taxpayer, such as using Artificial Intelligence and pattern recognition technology and regularly publish these answers online for the general public.

MSP #2 TRANSPARENCY OF THE OFFICE OF CHIEF COUNSEL: Counsel Is Keeping More of Its Analysis Secret, Just When Taxpayers Need Guidance More than Ever

Problem

The IRS Office of Chief Counsel (OCC) provides advice to headquarters employees called Program Manager Technical Advice (PMTA(s)). PMTAs must be disclosed to the public pursuant to a settlement with Tax Analysts. Due to the Tax Cuts and Jobs Act (TCJA), taxpayers need prompt guidance now more than ever. Notwithstanding their increased need to for guidance, the OCC (1) has been disclosing fewer PMTAs, (2) allows its attorneys to avoid disclosure by issuing advice as an email, rather than a memo; (3) has not issued written guidance to its attorneys describing what must be disclosed as PMTA; and (4) has no systems to ensure all PMTAs are timely identified, processed as PMTAs, and disclosed.

Analysis

The *right to be informed* is the first right listed in the Taxpayer Bill of Rights for good reason. If taxpayers do not know the rules and why the IRS has adopted them, they cannot determine if they should exercise their other rights (*e.g.*, the *right to challenge the IRS's position and be heard* or the *right to appeal an IRS decision in an independent forum*). Information about how the OCC interprets the law also helps them avoid taking positions that would incur penalties or ensnare them in audits or litigation. In its formal response to TAS, however, the OCC does not acknowledge that a function of its advice is "to inform taxpayers or practitioners about how it interprets the law," and says its failure to do so "is not a problem that taxpayers have" and "is not a serious problem encountered by taxpayers." Accordingly, it has declined to specify in writing what advice must be disclosed as PMTA, except to say that documents other than memoranda (*e.g.*, email) need *not* be disclosed. It also has no procedures to ensure PMTAs are timely identified. The results are predictable. Although it released 68 PMTA following tax law changes in 1998, it has released only 11 in 2018, only one of these related to the TCJA, and it was released only because of a request by the IRS, not because of the settlement with Tax Analysts.

Recommendations

The National Taxpayer Advocate recommends that the OCC should develop clear written guidance that defines when advice constitutes PMTA that must be disclosed; it should not withhold advice based on its form (*e.g.*, email); and it should establish a process to ensure advice that should be disclosed as PMTA is being identified and disclosed in a timely manner.

MSP #3 NAVIGATING THE IRS: Taxpayers Have Difficulty Navigating the IRS, Reaching the Right Personnel to Resolve Their Tax Issues, and Holding IRS Employees Accountable

Problem

Taxpayers often have difficulty locating IRS personnel who can provide accurate and responsive information regarding their cases. The IRS emphasizes its main toll-free phone line, which includes difficult-to-interpret options and often leads to extended hold times. Even when taxpayers are provided with a specific phone number, most often it is for a group, rather than for an individual employee. These group numbers make it difficult for taxpayers to have a sense of continuity and rapport with the personnel working their cases. Moreover, a lack of ownership on the part of IRS personnel who work these cases can decrease the efficiency and effectiveness of case resolutions and worsen the customer experience.

Analysis

The group numbers relied upon by the IRS as one of two primary mechanisms for addressing taxpayer inquiries sometimes leave much to be desired. For example, TAS conducted a test in which a hypothetical caller telephoned the IRS main toll-free line to ask questions about filing a request for an offer in compromise. That caller was kept waiting on hold for approximately one hour before finally giving up and terminating the call. Instead of improving telephone service, the IRS prefers to channel sometimes-unwilling taxpayers into online self-service venues, which the majority of users deem to be substandard in many respects. For example, under 20 percent of surveyed taxpayers thought the IRS website was easily searchable, well organized, and user-friendly. Accordingly, it is little wonder that the IRS has been recently ranked last in quality communication in a study of 15 federal agencies undertaken by Forrester Research. In addition to these communication shortcomings, the IRS has no overarching mechanism for allowing taxpayers to raise questions and complaints to managers directly and to hold both employees and managers accountable for addressing such complaints. Thus, even if taxpayers can navigate to the proper location within the IRS, no systemic institutional safeguards exist to ensure that their inquiries will be addressed accurately and responsively.

Recommendations

The National Taxpayer Advocate recommends that the IRS provide the IRS Telephone Directory for Practitioners or a similar directory to the general public; institute a 311-type system where taxpayers can be transferred by an operator to the specific office within the IRS that is responsible for their cases; adopt a model for correspondence examinations and similar cases in which a single employee is assigned to the case while it is open within the IRS function; and establish a complaint tracker that monitors and records requests to speak with supervisors, subsequent follow-up, and the results of that contact.

THE RETURN FILING PROCESS: Balancing Ease and Efficiency with Revenue Protection

MSP #4 FREE FILE: The IRS's Free File Offerings Are Underutilized, and the IRS Has Failed to Set Standards for Improvement

Problem

To fulfill its statutory duty to increase electronic filing (e-filing), the IRS partners with Free File, Inc. (FFI), a group of 12 private-sector tax return preparation software providers. This group offers two services—Free File software, which provides free options for online software to guide taxpayers with adjusted gross income of less than $66,000 through return preparation, and Free File Fillable Forms, a tool available for all taxpayers to enter their income tax forms digitally. Use of the Free File program has steadily declined, and only about 2.5 million people filed returns using Free File software in fiscal year (FY) 2018. The IRS is devoting minimal resources to oversight and testing of this program to understand why taxpayers aren't using it and how the services offered could be improved. When the services provided by FFI fail to meet the needs and preferences of taxpayers, particularly in underserved communities, it reflects poorly on the IRS and can further erode taxpayers' trust in fair tax administration.

Analysis

Electronic filing has increased greatly since 2002, but the goals of the Free File program have stagnated and use of the program has steadily declined. In tax year 2016, only 2.3 percent of eligible taxpayers used Free File software, and only 0.20 percent of eligible taxpayers used Free File Fillable Forms. The IRS currently has no marketing budget for the Free File program. It has not conducted effective evaluation of the program to understand the experience of taxpayers who do use the program or even if the terms of the agreement with FFI are being met. For example, the IRS no longer conducts Free File satisfaction surveys, which it claims is due to budget constraints, even though the Free File Memorandum of Understanding from 2018 specifically assigns the members of FFI the responsibility to "provide the necessary support to accomplish a customer satisfaction survey."

Age restrictions sharply curtail the number of FFI options available to elderly taxpayers, as only three of the 12 FFI providers offer services to taxpayers of all ages and five have age limitations that start before the age of 60. In filing season 2018, no Free File options were available for English as a Second Language (ESL) taxpayers. Testing by TAS shows several software providers have limitations in their navigational features and ability to help taxpayers correctly complete their returns, resulting in poor service quality. Furthermore, cross-marketing and advertising of other services on Free File software platforms can confuse taxpayers, and gives the impression of IRS endorsement of for-fee services. Because of these shortcomings, the services provided by FFI do not meet the needs and preferences of eligible taxpayers, undermining taxpayers' *rights to quality service* and *to pay no more than the correct amount of tax*.

Recommendations

The National Taxpayer Advocate recommends that the IRS develop actionable goals for the Free File program, including targeted-use percentages, prior to entering into a new agreement with Free File, Inc.; work with TAS to create measures evaluating taxpayer satisfaction with the Free File program and test each return preparation software's ability to complete various forms, schedules, and deductions; provide Free File Fillable Forms and Software options for ESL taxpayers; prepare an advertising and outreach plan to make taxpayers, particularly in underserved communities, aware of the services available through

the Free File program; allow Free File members to provide services to all taxpayers as a part of its next operating agreement instead of capping the percentage of eligible taxpayers each software provider can cover; redesign the Free File Software Lookup Tool to better direct taxpayers to software providers that best meet their circumstances; improve the capabilities offered to taxpayers through Free File Fillable Forms, including linking from IRS form instructions to IRS publications, providing increased guidance for common areas of taxpayer confusion, ensuring taxpayer's abilities to download, save, and print all forms with troubleshooting assistance, and creating a dedicated email where taxpayers can get help when experiencing technology glitches. If these recommendations are not adopted, the National Taxpayer Advocate recommends the IRS discontinue the Free File Program and create an improved electronic free fillable forms program including the features described above.

MSP #5 FALSE POSITIVE RATES: The IRS's Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers

Problem

IRS fraud detection systems generate high false positive rates (FPRs) and long processing times, which increase taxpayer burden, generate phone calls to the IRS, and create TAS cases. Several IRS policies affect the ability of taxpayers to timely receive legitimate refunds, including the IRS's failure to capture necessary information to evaluate the accuracy and efficiency of its non-identity theft (IDT) and IDT refund fraud programs; its past failure to check for third-party information on a daily, versus weekly, basis; and its failure to implement systemic verification capabilities in its fraud detection systems. Simple adjustments such as these could very well prevent taxpayers from being selected into the pre-refund wage verification process or could expedite the release of the return if selected, allowing the IRS to better use its resources to verify returns where there is a substantial potential for fraud.

Analysis

Although IRS fraud detection systems protected about $7.6 billion in revenue between January 1 and October 3, 2018, they also delayed the processing of almost $20 billion in legitimate refunds. Between January 1 and September 30, 2018, the FPR for non-IDT refund fraud filters was 81 percent, while the FPR for IDT refund fraud filters was 63 percent. Further, of the returns remaining in the non-IDT refund fraud program in 2018 after the two-week screening period and two-week review period, 64 percent were legitimate. The IRS refers to this 64 percent figure as the "operational performance rate" (OPR). The high FPR and long delays resulted in a 287 percent increase in TAS Pre-Refund Wage Verification Cases between January 1 and September 30, 2018, when compared to the same time period in the prior year, and in nearly half of the cases closed between January 15 and June 30, 2018, taxpayers ultimately received the refunds originally claimed on their returns.

Recommendations

The National Taxpayer Advocate recommends that the IRS calculate an "operational FPR" in addition to the FPR and OPR for non-IDT accounts to more accurately reflect the number of legitimate refunds that take more than four weeks to resolve; develop criteria to be used in measuring OPR for IDT accounts; study why it takes some taxpayers longer to authenticate their identities and what barriers they may encounter when attempting to do so; design the refund fraud system to consider if applying the third-party information to the return would actually result in a larger refund when there is a mismatch in information between third parties and taxpayers; request from outside vendors information on ways to improve the FPR, along with proposals to determine factors contributing to high FPRs; and establish a maximum acceptable FPR goal within industry accepted standards and an actionable timeline to achieve that goal, based on the information and proposals received from outside vendors.

MSP #6 IMPROPER EARNED INCOME TAX CREDIT PAYMENTS: Measures the IRS Takes to Reduce Improper Earned Income Tax Credit Payments Are Not Sufficiently Proactive and May Unnecessarily Burden Taxpayers

Problem

When the IRS allows a taxpayer's erroneous claim of the Earned Income Tax Credit (EITC), it makes an "improper payment." The IRS estimates that 25 percent of the EITC credits it allowed in fiscal year (FY) 2018 were improper payments (23.4 percent, when considering improper payments the IRS recovered). A principal cause of the EITC improper payment rate is the complexity of the rules for claiming EITC, yet the IRS does not provide a dedicated telephone help line available year-round for taxpayers to call with questions about EITC. Recent measures Congress adopted to reduce the improper payment rate (*e.g.*, legislation requiring submission of third-party income reports by January 31 and delaying EITC refunds until February 15) may be effective, but will not be reflected in the IRS's estimate for years. In the meantime, in attempting to address improper payments, the IRS may unnecessarily burden taxpayers by seeking expanded math error authority and imposing bans on claiming the credit.

Analysis

The improper payment estimate does not reflect the fact that for every dollar of EITC improper payments, 40 cents of EITC went unclaimed by taxpayers who appear to be eligible for the credit. EITC misreporting accounts for only about six percent of the gross tax gap, and compared to non-tax payment or benefit programs, the cost of administering the EITC program (around one percent of benefits delivered) is relatively low, while the EITC participation rate (79 percent) is relatively high. TAS studies show that sending tailored communications to those who appear to have claimed the credit in error may avert future erroneous claims.

Recommendations

The National Taxpayer Advocate recommends that the IRS seek a permanent exemption from the Office of Management and Budget requirement to include recovered improper payments in the improper payment rate. The IRS should collaborate with TAS to identify a method of identifying taxpayers who do not claim EITC but are eligible for the childless worker EITC, and automatically award the childless worker credit to those taxpayers. The IRS should also collaborate with TAS to identify the changes to Form 1040 that would be needed, and the data gathering techniques that could be employed, to award to EITC to taxpayers who are eligible for EITC with respect to a qualifying child but do not claim it on their returns. The IRS's soft notices sent to taxpayers advising them they may have claimed EITC in error should be revised to explain the error the taxpayer appears to have made, and the IRS should establish a dedicated, year-round toll-free help line staffed by IRS personnel trained to respond to EITC and Child Tax Credit questions.

MSP #7 RETURN PREPARER OVERSIGHT: The IRS Lacks a Coordinated Approach to Its Oversight of Return Preparers and Does Not Analyze the Impact of Penalties Imposed on Preparers

Problem

In 2018, more than half of the tax returns submitted by return preparers were from individuals who are unregulated by the IRS. It is a necessary part of the IRS's duties to ensure that preparers are competent and accountable, since return preparers play such a critical role in tax administration and in promoting tax compliance. The public needs a way to differentiate between professional, competent, and experienced preparers and their incompetent or unscrupulous counterparts.

Analysis

The IRS had started to implement a program to impose minimum competency requirements on the unenrolled tax preparation profession. However, in 2013, the District Court for the District of Columbia enjoined the IRS from regulating tax return preparers via testing and continuing education requirements. Although the IRS cannot mandate return preparers pass competency tests or undergo continuing education, there is still a need for the IRS to provide a certain level of oversight. Rather than designating one centralized Commissioner-level office to coordinate oversight of return preparers, the IRS has spread this responsibility across several organizations, including (1) the Return Preparer Office to oversee registration of preparers, (2) the Office of Professional Responsibility to interpret and apply Circular 230, (3) Wage and Investment's Return Integrity and Compliance Services function to develop a Refundable Credits Return Preparer Strategy, (4) Small Business/Self-Employed's Return Preparer Program, and (5) Criminal Investigation's Abusive Return Preparer Program.

In May 2018, the IRS convened a cross-functional team tasked with developing a coordinated servicewide return preparer strategy. (Representatives from TAS were not invited to this team.) The IRS to date has not delivered a comprehensive, coordinated strategy. Moreover, with respect to penalties, it has a no change rate of about 15 percent, and the IRS collects only about 15 percent of the penalties it assesses. Beyond preparer audits, the IRS does not have a strategic plan for using letters and soft notices to drive future preparer compliance, and where it does use such letters, it does not routinely measure the future compliance impact.

Recommendations

The National Taxpayer Advocate recommends that the IRS invite representatives from TAS to the cross-functional team that was established to develop a coordinated strategy to provide effective oversight of return preparers; develop a comprehensive plan to communicate the coordinated return preparer strategy to Circular 230 preparers and unenrolled preparers; develop a community-based, grassroots communication strategy for educating vulnerable taxpayer populations about how to select a competent return preparer and the risk of return preparer fraud; conduct analysis on the impact of penalty assessments and soft notices on preparers' behavior in subsequent years, and publish the findings; and revise letters and notices that reference the Directory of Federal Tax Return Preparers to ensure that appropriate caveats are clearly articulated.

THE EXAMINATION PROCESS: Minimizing Taxpayer Burden in the Selection and Conduct of Audits

MSP #8 CORRESPONDENCE EXAMINATION: The IRS's Correspondence Examination Procedures Burden Taxpayers and are not Effective in Educating the Taxpayer and Promoting Future Voluntary Compliance

Problem

IRS correspondence audits may involve complicated rules and procedures, or complicated fact situations, or both as in the case of the Earned Income Tax Credit (EITC). Taxpayers in correspondence exams may suffer greater burden because of the difficulty of sending and receiving correspondence (including having it considered at the right time); the lack of clarity in IRS correspondence; and the lack of a single employee assigned to the taxpayer's case. Correspondence examiners do not receive sufficient training on complex issues, and IRS correspondence exam measures do not adequately consider taxpayer needs and preferences. These problems are exacerbated when the audited taxpayer is low income or has limited English proficiency, or when there are other impediments that hinder communication during the audit.

Analysis

In fiscal year (FY) 2017, the IRS audited almost 1.1 million tax returns (including business and individual returns), approximately 0.5 percent of all returns received that year. During FY 2017, the IRS conducted approximately 71 percent of all audits (business and individual) by correspondence. For FY 2018 correspondence audits, the IRS took more than 65 days to respond to the majority of taxpayer replies in refundable credit cases. During FY 2018, Small Business/Self-Employed (SB/SE) division exam employees answered the exam phone only about 35 percent of the time. An examination is primarily an education vehicle, so the taxpayer learns the rules, corrects mistakes, and can comply in the future. In fact, the IRS gains about twice as much from the long-term effects of an audit than it does from the actual audit itself. Yet, a significant number of correspondence audits—about 42 percent—were closed with no personal contact in FY 2018. IRS correspondence and forms are inadequate to inform and educate taxpayers, and they fail to include contact information for the employee who reviewed the taxpayer's reply. The measures for correspondence exams are inadequate to determine whether the IRS is choosing the best cases to audit, educating the taxpayer, and increasing future compliance.

Recommendations

The National Taxpayer Advocate recommends the IRS require at least one personal contact between an IRS employee and the taxpayer before closing a correspondence exam; measure taxpayers' filing compliance following correspondence exams and apply this data to guide audit selection; continue to assign a single employee for a correspondence exam when the IRS receives a response from the taxpayer by phone or mail, and expand by retaining this employee as the single point of contact throughout the exam; place on outgoing taxpayer correspondence the name and telephone number of the tax examiner who reviewed the taxpayer's correspondence where a tax examiner has reviewed and made a determination regarding that specific documentation; conduct surveys of taxpayers following correspondence examinations to gauge their understanding of the exam process and their attitudes towards the IRS and towards filing and paying taxes; collect data about which forms of taxpayers' documentation were deemed insufficient in a correspondence exam and revise existing correspondence exam letters to better explain documentation requirements; and end the practice of using the combination letter and provide taxpayers with an initial contact prior to issuing the preliminary audit report.

MSP #9 FIELD EXAMINATION: The IRS's Field Examination Program Burdens Taxpayers and Yields High No Change Rates, Which Waste IRS Resources and May Discourage Voluntary Compliance

Problem

The primary objective in identifying tax returns for examination is to promote the highest degree of voluntary compliance. Yet the IRS does not know whether its field exams are promoting voluntary compliance because it does not have a measure to track future filing compliance post-audit. Instead, the IRS focuses primarily on the bottom line and the direct effects of a specific audit—measuring closures, cycle time, employee satisfaction, and quality scores. The IRS may also be selecting the wrong taxpayers and cases for field audit, given declining resources. High no change rates for field audits show that the IRS may be wasting resources and failing to drive future voluntary compliance. From a taxpayer's perspective, the field examination process is not working as intended because some taxpayers may not have access to all IRS employees making decisions about their issues, or do not know how to elevate an issue or a complaint. Others experience difficulty understanding the scope of the audit due to a lack of transparency or overly broad document requests. These shortcomings impair taxpayers' rights *to be informed* and *to quality service*.

Analysis

The IRS has conducted fewer field exams in recent years, with approximately 272,000 field exams in fiscal year (FY) 2010 and only about 156,000 field exams in FY 2018. Both operating divisions conducting field audits, Small Business/Self-Employed (SB/SE) and Large Business and International (LB&I), in FY 2018 employed only about 60 percent of the Revenue Agents they had in FY 2010, reflecting the IRS may need to be more discriminating in choosing cases. Yet SB/SE selects over half of its field audits based on a related-year audit, meaning instead of auditing a new taxpayer, it opens an audit on another tax year for a taxpayer already under audit. Although LB&I created the campaign program to be more nimble in identifying trends, currently campaigns only comprise about six percent of its audit work. Both SB/SE and LB&I track audit reconsiderations, but neither tracks how many of these reconsiderations are eventually appealed by the taxpayer. Thus, the IRS does not know when an examiner gets the answer wrong or when there are hazards of litigation, both of which should inform audit selection. Research shows that audits proposing no additional tax ("no change" audits) result in greater future noncompliance; yet field exams have unacceptably high no change rates—averaging 23 percent for SB/SE field audits and 32 percent for LB&I field audits from FY 2010 to FY 2018. No change audits negatively affect voluntary compliance: a recent study found Schedule C taxpayers reduced their reported income in the three years after a no change audit by about 37 percent. Finally, the field exam programs do not have a formal centralized system to track taxpayer complaints and requests to speak to a manager, so the IRS cannot track and analyze taxpayer concerns about the conduct of an audit.

Recommendations

The National Taxpayer Advocate recommends the IRS periodically survey taxpayers after field exams to determine the impact of the exam on the taxpayers' understanding of the audit process and audit adjustments, and attitudes towards the IRS and filing and paying taxes; periodically study taxpayers' filing behavior following field exams to determine whether the exams had an impact on whether the taxpayer filed, how much income the taxpayer reported, and whether the taxpayer repeated a mistake made on a previous return; require SB/SE to provide an examination plan like what LB&I requires for all audited taxpayers for all field examinations; notify taxpayers during an audit of any consultations

with specialists and provide an opportunity for taxpayers to discuss with the specialist any technical conclusions that result from these consultations; track and report on the number of field examinations (including audit reconsiderations) that go to Appeals and the resulting adjustments.

MSP #10 OFFICE EXAMINATION: The IRS Does Not Know Whether Its Office Examination Program Increases Voluntary Compliance or Educates the Audited Taxpayers About How to Comply in the Future

Problem

Promoting voluntary compliance should be an underlying goal of the IRS examination process; however, failure to appropriately measure the outcomes of examinations and the scope of the office examination program may limit its effectiveness. Office exams typically examine a limited scope of issues, which provides a structure to the exam and helps the taxpayer focus specifically on how to better comply in the future. The IRS employee has an opportunity to educate the taxpayer in-person and ensure the taxpayer understands the law going forward. The face-to-face experience benefits both the taxpayer and the IRS—the taxpayer can, in real time, ask questions and explain his or her position to the IRS, and the IRS employee can immediately see if the taxpayer understands the current examination, next steps to be taken, and how to comply in the future. Compare this with the correspondence examination process where a taxpayer with limited understanding of the law may never speak to an IRS employee during the entire process.

Analysis

Office exams are generally scheduled at the office closest to the taxpayer's residence, if the office has the appropriate examination personnel on site. This constraint immediately limits which taxpayers may ever be selected for office exam. Selecting taxpayers for office exam based on where Tax Compliance Officers (TCOs) are located introduces selection bias into the office exam process and impacts the *right to quality service* and the *right to a fair and just tax system*. The employees who conduct office exams have declined precipitously. In fiscal year (FY) 2011, the IRS had 1,256 employees conducting office exams and in FY 2018, only 639, a decrease of 49 percent in only seven years. Since office exams have a higher agreed-to rate than correspondence exams, they can serve as a more effective means to get to the right answer for the taxpayer as well as educating him or her about future compliance. If the IRS's goal is to promote voluntary compliance through the examination process, it needs to measure how taxpayers who undergo audits comply in future years. Currently the IRS relies on typical measures of cycle time, closure rates, quality scores, and employee satisfaction in evaluating the examination process. None of these measures address the impact of audits on voluntary compliance, whether the taxpayer understood why his or her tax was adjusted, or whether the examination concluded in the right result for the taxpayer—*i.e.*, what happens when a taxpayer appeals the results of the exam?

Recommendations

The National Taxpayer Advocate recommends that the IRS develop measures to track the downstream compliance of audited taxpayers by type of exam; track results of audits that are appealed by the taxpayer by type of exam; add educating the taxpayer on future compliance to the quality attributes of an exam for field and office exam; increase the number of TCOs and put them in more locations throughout the United States, expand the issues covered by office exam; and develop pilot programs for office exams for issues such as the Earned Income Tax Credit, and track the customer satisfaction for these pilots versus taxpayers audited via correspondence exam for the same issues.

MSP #11 POST-PROCESSING MATH ERROR AUTHORITY: The IRS Has Failed to Exercise Self-Restraint in Its Use of Math Error Authority, Thereby Harming Taxpayers

Problem

When a return appears to contain one of 17 types of errors (misleadingly called math errors), the IRS can summarily assess additional tax without first giving the taxpayer a notice of deficiency, which triggers the right to petition the Tax Court. This "math error authority" (MEA) can deprive taxpayers of benefits to which they are entitled and leave them with no realistic opportunity for judicial review. The taxpayer is best equipped to address the IRS's questions immediately after filing. On April 10, 2018, however, the IRS concluded that it can use MEA after processing the return. It used this newfound post-processing MEA to reverse and recover refundable credits for students, children, and the working poor on 17,691 returns in fiscal year 2018—often nearly two years after the returns were filed. It improperly denied credits to 289 taxpayers and sent 113 taxpayers the wrong letters to explain why their credits were disallowed, according to the Treasury Inspector General for Tax Administration (TIGTA). TIGTA also said it wasted over $400,000 doing manual reviews because it did not address the problem systemically and did not reject e-filed returns—a process that would have allowed taxpayers or their preparers to address the problem immediately. The National Taxpayer Advocate is concerned that the IRS may continue to use MEA and its new post-processing MEA in situations where it poses unacceptable risks to the taxpayer's right *to pay no more than the correct amount of tax* or *to challenge the IRS's position and be heard*, and wastes more IRS resources.

Analysis

MEA burdens taxpayers because (1) mismatches do not always mean the assessment is correct, (2) the IRS does not always try to resolve apparent discrepancies on its own, (3) confusing letters and shorter deadlines make it more difficult for taxpayers to respond timely as compared to the audit process, and (4) if they miss the deadlines, taxpayers generally lose access to the Tax Court. Post-processing MEA exacerbates these burdens because the longer the IRS waits to question the return, the less likely the taxpayer is to be able to (1) receive and understand the IRS's letter, (2) discuss the issue with a preparer, (3) access underlying documentation, (4) recall and explain relevant facts, (5) return any refunds without suffering an economic hardship, and (6) learn how to avoid the problem before filing another return. Thus, if the IRS does not use MEA when processing the return, an audit is generally more appropriate. The National Taxpayer Advocate has recommended legislation that would limit MEA to situations least likely to burden taxpayers or waste IRS resources.

Recommendation

The National Taxpayer Advocate recommends that the IRS adopt a policy statement or similar guidance which voluntarily limits the circumstances in which it will use MEA. The policy statement should adopt the limits she recommended to Congress and bar the use of post-processing MEA. It should also require the IRS to alert taxpayers to any discrepancies as early as possible (*e.g.*, immediately upon receipt) rather than waiting to use MEA, or waiting even longer to use post-processing MEA.

THE NOTICE FUNCTION: IRS Written Communication with Taxpayers

MSP #12 MATH ERROR NOTICES: Although the IRS Has Made Some Improvements, Math Error Notices Continue to Be Unclear and Confusing, Thereby Undermining Taxpayer Rights and Increasing Taxpayer Burden

Problem

Math error authority allows the IRS to summarily resolve mathematical (*e.g.*, 2 + 2 = 5) and clerical (*e.g.*, writing 12 for an entry on the return instead of 21, or leaving an entry blank) errors with taxpayers' tax returns that are obvious just by looking at the face of the return. However, the range of issues that fall under these definitions has steadily expanded and the IRS is using math error authority to summarily resolve more complex issues. Concerned with protecting taxpayer rights, Congress directed the IRS to provide taxpayers with an explanation when it makes an adjustment to taxpayers' returns. The IRS does this by sending taxpayers a math error notice. The explanation of the adjustment in the math error notice is critical to taxpayers' ability to challenge the adjustment and preserve their right to petition the U.S. Tax Court, before paying the tax, by timely requesting abatement. Despite the congressional directive, many math error notices remain confusing and lack clarity. This makes it difficult for taxpayers to determine what, specifically, the IRS corrected on their return and whether they should accept the adjustment or request a correction, as well as the consequences of inaction.

Analysis

While using math error authority is cheaper and faster than normal deficiency procedures, it does not afford taxpayers the same protections they would otherwise have. For example, math error notices do not give taxpayers the right to petition the U.S. Tax Court to challenge the IRS's decision. Taxpayers must request the IRS abate the change within a shorter timeframe than normal deficiency procedures (60 days versus 90 days) to retain their right to petition the Tax Court before paying the tax. These lesser protections and shortened timeframes make the clarity of math error notices especially important. In calendar years 2015-2017, the IRS issued approximately two million math error notices each year. However, the IRS does not track the abatement rates of math errors.

Many math error notices lack clarity, only giving taxpayers short, generic explanations of the purported errors, without adequately directing taxpayers to the exact issue with their return or all of the steps they must take. Additionally, math error notices are designed like bills, framed to emphasize payment by taxpayers, without first explaining the math error issues or the rights taxpayers have to challenge the IRS's determination. The design of the notices deemphasizes, and in some cases omits, that taxpayers lose their right to make a prepayment petition to the Tax Court if they don't request the IRS abate the tax within 60 days of receiving the notice. A TAS study found that in a sample of cases, the IRS summarily denied tax benefits to taxpayers that many of them were entitled to, which further demonstrates the need for clarity and explicit notice of taxpayers' right to challenge the change to the return in case the IRS made a mistake. Instead of denying taxpayers benefits they are entitled to, the IRS should examine historical return data to summarily correct transposed digits or missing information, such as a dependent Taxpayer Identification Number, on the taxpayer's return if it would benefit the taxpayer.

Recommendations

The National Taxpayer Advocate recommends that the IRS cite in its math error notices the exact line on the tax return where it made a change, along with the reason that the IRS made the change; frame the notices in the context of taxpayer rights, so that taxpayers are aware of their right to challenge the IRS's decision; use the available psychological, cognitive, and behavioral science research to design its notices, walking taxpayers through the necessary steps they must take in response to the math error notice and the exact date by which they need to request the IRS reverse the change to retain their right to prepayment appeal; include the explanation of the error, deadline date to appeal, information about the Taxpayer Bill of Rights, Taxpayer Advocate Service, and Low Income Taxpayer Clinics on the first page of the notice; measure abatement rates by math error issue and review if there are problems with particular notices or issues that have high abatement rates; and use its internal data to make corrections to returns that benefit taxpayers.

MSP #13 STATUTORY NOTICES OF DEFICIENCY: The IRS Fails to Clearly Convey Critical Information in Statutory Notices of Deficiency, Making it Difficult for Taxpayers to Understand and Exercise Their Rights, Thereby Diminishing Customer Service Quality, Eroding Voluntary Compliance, and Impeding Case Resolution

Problem

The statutory notice of deficiency (SNOD) notifies the taxpayer there is a proposed additional tax due, identifying the type of tax, and period involved, and that the taxpayer has the right to bring suit in the United States Tax Court before assessment and payment. If the taxpayer does not petition the Tax Court, after the 90 days (or 150 days if the taxpayer resides outside the United States) expires, the IRS will assess the tax, send the taxpayer a tax bill, and start collection. The SNOD is the taxpayer's "ticket" to the Tax Court, the only pre-payment judicial forum where the taxpayer can appeal an IRS decision. However, data suggests that less than one percent of the taxpayers in 2017 who received a SNOD filed a petition with the Tax Court, not availing themselves of a fundamental taxpayer right—the *right to appeal an IRS decision in an independent forum*. These taxpayers may not be availing themselves of their rights, in part because of faulty design and poor presentation of information in the notices. The SNODs do not effectively communicate the information needed for taxpayers to understand their rights and the consequences for not exercising them, the relevant tax issues, or how to respond. Nor do notices sufficiently apply plain writing principles or incorporate behavioral research insights, as directed by the Plain Writing Act and Executive Order 13707. Additionally, the IRS continues to omit Local Taxpayer Advocate (LTA) information required by law on certain SNODs, thereby violating taxpayer rights.

Analysis

The SNOD is critical to many low income and middle income taxpayers because generally without it they would be required to pay the tax first and go to refund fora, such as federal district courts or the United States Court of Federal Claims, in order to challenge the tax adjustment. Approximately 69 percent of cases in Tax Court are brought by unrepresented taxpayers, and that percentage increases to 91 percent among cases where the deficiency for a tax year is $50,000 or less and the taxpayer elects small tax case (S Case) procedures. In fiscal year (FY) 2017, the IRS issued more than 2.7 million of the four types of SNODs that are separately tracked (called the "3219 SNODs"). There were only about 27,000 docketed cases in Tax Court that year however, suggesting that less than one percent of taxpayers who received a SNOD filed a petition with the Tax Court. The IRS tracks the income level of taxpayers receiving three of the 3219 SNODS, excluding the SNODs issued to those who did not file a return. The majority of these three types of 3219 SNODs (called the Non-Automated Substitute for Return, or Non-ASFR SNODS) were issued to low income taxpayers. Nearly 59 percent of those receiving a Non-ASFR SNOD make less than $50,000 per year. Yet low income taxpayers, who may be eligible for representation through Low Income Taxpayer Clinics (LITCs), are less likely to petition the Tax Court. In FY 2018, the median total positive income for individuals who *did not* petition the Tax Court in response to a SNOD issued after an audit was about $24,000.

Recommendations

The National Taxpayer Advocate recommends that the IRS redesign the notices of deficiency, using plain language principles and behavioral science methods, to clearly convey the taxpayer's proposed tax increase, his or her right to challenge the IRS's determination before the Tax Court, and his or her ability to obtain TAS or LITC assistance; collaborate with the Taxpayer Advocate Service and stakeholders, especially the Taxpayer Advisory Panel and LITCs, in designing the SNOD; conduct a pilot of several SNODs, including current notices and rights-based prototypes, to measure: (1) the

petition rate of each notice; (2) the TAS contact rate for each notice; (3) the IRS contact rate for each notice; and (4) the downstream consequences of each notice (*e.g.*, disposition of cases, such as whether the taxpayer settled, conceded, or prevailed in Tax Court and whether the taxpayer's deficiency decreased or the taxpayer requested an audit reconsideration); develop and train IRS employees in best practices for assisting taxpayers who call the IRS in response to a SNOD, including having IRS employees remind and guide taxpayers in filing Tax Court petitions; facilitate the process for petitioning the Tax Court by including with the notice of deficiency the Tax Court website and telephone number, as well as a copy of IRS Publication 4134, *Low Income Taxpayer Clinic List*; include the Local Taxpayer Advocate's contact information on the face of the notices, and develop a timeline to secure and allocate funding to implement the necessary IRS system upgrades to allow for the programming of LTA addresses and contact information on the face of computer-generated letters, as required by law.

MSP #14 COLLECTION DUE PROCESS NOTICES: Despite Recent Changes to Collection Due Process Notices, Taxpayers Are Still at Risk for Not Understanding Important Procedures and Deadlines, Thereby Missing Their Right to an Independent Hearing and Tax Court Review

Problem

Collection Due Process (CDP) rights provide taxpayers with an independent review by the IRS Office of Appeals of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action, which can be appealed to Tax Court. The IRS communicates these important rights during two critical times. The IRS communicates the right to request a CDP administrative hearing with the intent to levy notice or the NFTL. Following the CDP hearing, the IRS communicates its determination to the taxpayer via a notice of determination. Perhaps because the notices provide confusing instructions regarding the due date to file a response, the response rate for CDP notices ranges from under one percent to over ten percent. Moreover, CDP notices emphasize collection actions and under-emphasize the statutory due process protections afforded by the hearings, leading unrepresented taxpayers to not avail themselves of important taxpayer rights.

Analysis

The National Taxpayer Advocate and other stakeholders have highlighted specific problems with the way in which the CDP notices do not fully inform taxpayers. First, the design and wording in CDP notices underemphasize the importance of CDP rights. They do not explain what a hearing is, why a taxpayer would want to request one, and what an equivalent hearing is. Second, the notices do not clearly mention important information, such as a deadline by which to file a hearing request. Last, the notice of determination lacks a specific date by which to file a petition in Tax Court and does not explain why the notice is salient to taxpayers.

Applying principles of behavioral science help us understand how these notices should be improved. Taxpayers are more likely to read material if it is salient to them. Providing a full explanation on the importance of CDP rights and what they are losing if they do not request a hearing may prompt taxpayers to exercise their rights. Moreover, providing them with information about the availability of a Low Income Taxpayer Clinic (LITC) for representation may overcome the barrier posed by self-representation. Last, plain language includes more than just simple wording. It includes structuring the notice so that it is easy to read and setting apart important information to guide the reader. This means that things such as a filing deadline should appear early in the notice and in bold font. With improved notices, perhaps the CDP response rates will increase.

Recommendations

The National Taxpayer Advocate recommends that the IRS include the date on the Notices of Determination by which the taxpayer must file a petition in Tax Court; work with TAS to redesign the CDP notices so that they reflect the principles of visual cognition and processing of complex information. This will include changes such as putting clear explanations about the importance of these hearings in terms relating essential information related to taxpayer rights and protections, and highlighting deadlines early in the notices and in bold font; include references to TAS and the LITC program; and work with TAS to explore methods of more accurate notification of the due date for CDP hearing requests with respect to lien filings.

THE IRS COLLECTION FUNCTION: Minimizing Taxpayer Burden and Addressing Taxpayers' Ability to Pay

MSP #15 ECONOMIC HARDSHIP: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process

Problem

Economic hardship, as defined in Treasury regulations and the Internal Revenue Manual, occurs when an individual is "unable to pay his or her reasonable basic living expenses." Although Congress requires the IRS to halt some collection actions, like a levy, if a taxpayer is in economic hardship, the IRS is not proactive in identifying these taxpayers throughout the collection process. This means that the IRS does not have a method to alert collection employees that a taxpayer may be at risk of economic hardship and, when responding to taxpayer inquiries, to ask questions about the taxpayer's finances to determine an appropriate collection action or alternative. As a result, taxpayers may be lured into entering installment agreements (IAs) they cannot afford, violating their *right to be informed*, *right to quality service*, and *right to a fair and just tax system*.

Analysis

The IRS routinely undertakes collection treatments without performing the financial analysis required to make a hardship determination. For example, taxpayers need not submit any financial information to qualify for streamlined IAs and may enter into them online without interacting with an IRS employee. Many anxious or intimidated taxpayers seeking to resolve their liabilities as quickly as possible may be unaware the IRS is required to halt collection action if they are in economic hardship, and thus agree to make tax payments they cannot afford. Over the last six years, taxpayers whose cases were assigned to the IRS's Automated Collection System (ACS) entered into nearly 4.3 million IAs. About 84 percent of those IAs were streamlined. TAS estimates that about 40 percent of taxpayers who entered into a streamlined IA within ACS in fiscal year (FY) 2018 had incomes at or below their Allowable Living Expenses (ALEs), the standards the IRS uses in determining ability to pay a tax liability. In other words, four out of every ten taxpayers who agreed to streamlined IAs in ACS could have been eligible for collection alternatives, such as offers in compromise (OICs) or "currently not collectible - hardship" (CNC-Hardship) status, if they had known or been asked to explain their financial circumstances. The default rate within ACS for streamlined IAs of taxpayers whose income was at or below their ALEs in FY 2018 was about 39 percent.

The TAS Research function has developed an automated algorithm that we believe can identify taxpayers with incomes below their ALEs with a high degree of accuracy. The IRS could apply this formula by automation to the accounts of all taxpayers who owe back taxes, and then place a marker on the accounts of taxpayers whom the screen identifies as having incomes below their ALEs. While this marker would not automatically close a case as CNC-Hardship, it could be used to create a warning for telephone assistors responding to taxpayers calls and for taxpayers entering into IAs online. The IRS could also use this algorithm to screen out these taxpayers from automated collection treatments such as the Federal Payment Levy Program, selection for referral to Private Collection Agencies (PCAs), or passport certification unless and until the IRS has made a direct personal contact with the taxpayer to verify the information.

Recommendations

The National Taxpayer Advocate recommends that the IRS use an algorithm to compare a taxpayer's financial information to ALEs during case scoring and to use in a template available to Revenue Officers and telephone assistors responding to taxpayer inquiries; use this algorithm as a filter before sending any cases to PCAs and exclude any case involving a taxpayer at risk of economic hardship from potentially collectible inventory; route cases identified as at risk of economic hardship to a specific group within ACS and send those taxpayers a specific written notification to educate them on collection alternatives and additional assistance available, including TAS and the Low Income Taxpayer Clinics (LITCs); create a new help line dedicated to responding to taxpayers at risk of economic hardship and helping them determine the most appropriate collection alternative, including OICs; partner with TAS and LITCs to develop issue-focused training for IRS employees working with taxpayers at risk of economic hardship.

MSP #16 FIELD COLLECTION: The IRS Has Not Appropriately Staffed and Trained Its Field Collection Function to Minimize Taxpayer Burden and Ensure Taxpayer Rights Are Protected

Problem

Field Collection works cases that have not been resolved through the notice stream or through the Automated Collection System (ACS). In general, to resolve cases, Revenue Officers can file a lien, issue a levy, seize assets, recommend suits to foreclose on a federal tax lien or reduce the tax debt to judgment. Notwithstanding their responsibility to collect tax, Revenue Officers must adhere to taxpayers' right to privacy and right to a fair and just tax system, and they have the responsibility to educate the taxpayer in order to avert future noncompliance. The current state of Field Collection has impaired the ability of Revenue Officers to fulfill their mission in accord with the Taxpayer Bill of Rights. The National Taxpayer Advocate has the following concerns: (1) Revenue Officers are not as accessible to taxpayers, and are less able to assess economic conditions on the ground; (2) IRS procedures do not provide for early intervention by Revenue Officers; (3) Revenue Officers are not given the appropriate tools to effectively collect revenue; and (4) IRS metrics for evaluating the effectiveness of Field Collection are incomplete.

Analysis

The Field Collection function is the final depot in the collection roadmap. The function relies on Revenue Officers to work all tax accounts that were not resolved in the notice stream and the ACS. Aspects of a Revenue Officer's responsibilities include education, research and investigation, and appropriate enforcement. Because they are expected to engage in personal contact with taxpayers, it is important for Revenue Officers to maintain a geographic presence in the communities in which they serve. In recent conversations TAS held with stakeholder groups, practitioners voiced concern about the difficulty in not only arranging face-to-face meetings, but even in reaching Revenue Officers via phone or having them return calls.

By the time a Revenue Officer makes contact, taxpayers may be unable to pay the debt in full because the debt has grown so large as a result of accrued penalties and interest, or because the taxpayer's financial condition has deteriorated over time. Thus, it is imperative that a Revenue Officer quickly assess the taxpayer's situation and take early intervention measures, as appropriate. The National Taxpayer Advocate has advocated for the benefits of early intervention; it is an effective measure in promoting tax compliance and closing the noncompliance gap on employment taxes.

The IRS has slashed three-quarters of its training budget from fiscal year (FY) 2010 to FY 2017, and is moving away from face-to-face training in favor of virtual learning. In FY 2018, there were at least eight times as many virtual training sessions as there were in-person training sessions.

Recommendations

The National Taxpayer Advocate recommends that the IRS formally evaluate the impact on taxpayers of hoteling Revenue Officers; implement lessons from the "Fresh Inventory" pilot to modify its case selection and assignment methodologies; implement the Early Interaction Initiative to ensure business taxpayers are in compliance with and educated on the federal tax deposit requirements for employment taxes; issue a policy for an "RO of the day" in all field offices, so wherever they are located in the country, receives the same quality service; conduct and participate in outreach events that provide information on policy and procedures of Field Collection and the role of Revenue Officers; establish

a quality measurement system that measures (using a statistically valid sample) the future voluntary compliance impact of Field Collection actions, including if those actions resulted in undue harm or burden to taxpayers; and grant Revenue Officers the authority to work offer in compromise cases.

MSP #17 IRS's AUTOMATED COLLECTION SYSTEM (ACS): ACS Lacks a Taxpayer-Centered Approach, Resulting in a Challenging Taxpayer Experience and Generating Less Than Optimal Collection Outcomes for the IRS

Problem

The Automated Collection System (ACS) is a major IRS automated collection inventory system used to send notices demanding payment, and to issue notices of federal tax lien (NFTLs) and levies. ACS employees also answer taxpayer telephone calls to resolve balance due accounts and delinquencies. In recent years, ACS has drifted away from its philosophy of understanding the cause of the tax debt, considering collection alternatives, and ensuring that these collection alternatives enable future voluntary compliance. Instead, ACS today primarily focuses on collecting the tax owed without securing or discussing the facts surrounding the taxpayer's particular situation.

Analysis

At the end of fiscal year (FY) 2018, ACS had about $47 billion placed in its inventory and it collected about $3.4 billion of that amount during the same time period, and about $4.3 billion was collected through installment agreements (IAs), for a total collection of nearly $8 billion. However, ACS transfered $13.6 billion to the queue, an electronic holding area for accounts that will not be worked immediately. Additionally, $3.2 billion was collected through refund offsets (*i.e.*, without any action by an ACS employee or any interaction with the taxpayer).

ACS is actively trying to avoid person-to-person interaction with taxpayers. For example, it stopped issuing a letter previously sent to taxpayers systemically, *LT16: Request for Taxpayer to Contact ACS*, in order to decrease the number of taxpayers calling ACS, which in turn would help improve the ACS level of service (LOS)—63 percent for filing season (FS) 2018. Moreover, ACS notices proposed in redesign studies omit the name and phone number of an individual ACS employee, and any focus on taxpayer rights.

ACS heavily relies on streamlined IAs: $4.3 billion of the total FY 2018 collections (almost $8 billion) were collected pursuant to streamlined IAs. Streamlined IAs do not require financial analysis, and taxpayers agree to payments they cannot afford. Taxpayers in ACS whose income did not exceed their ALEs defaulted on their streamlined IAs 39 percent of the time in FY 2018. ACS does not prioritize working defaulted IA cases, thereby missing an opportunity to quickly engage a taxpayer who has previously shown initiative to resolve their tax debt.

In 2009, the Tax Court held, in *Vinatieri v. Commissioner*, that when the IRS sustains even a *proposed* levy on a taxpayer it knows is in economic hardship, it abuses its discretion. Ten years later, ACS employees continue to take action that is inconsistent with the *Vinatieri* decision.

Recommendations

The National Taxpayer Advocate recommends that the IRS assign one ACS employee located in the same geographic region as the taxpayer to a case; provide this employee's contact information on each notice to the taxpayer; send out monthly reminders to taxpayers regarding their tax liabilities and accrued penalties and interest; revise ACS notices using a Taxpayer Bill of Rights framework that conspicuously informs taxpayers of the rights impacted by a given notice; apply an indicator to cases in which the taxpayer is likely experiencing economic hardship and route these cases to a separate Economic Hardship Shelter excluded from assignment to private collection agencies; revise ACS's

Internal Revenue Manual and scripts to instruct employees that when a taxpayer's account bears an economic hardship indicator to consider all possible avenues for resolution, including partial payment IAs, offers in compromise, or Currently Not Collectible hardship status; conduct a research study to determine if ACS is truly working the "next best case" or if other cases in the queue may in fact prove more productive; and reorder ACS protocols to give high priority to cases where a taxpayer has defaulted on an IA.

MSP #18 OFFER IN COMPROMISE: Policy Changes Made by the IRS to the Offer in Compromise Program Make It More Difficult for Taxpayers to Submit Acceptable Offers

Problem

This year, the National Taxpayer Advocate studied business offers in compromise (OICs) out of concern that the IRS is not doing enough to help business taxpayers file successful OICs. Additionally, the IRS made changes that create barriers to all taxpayers from submitting successful OICs. First, not every state has an OIC Specialist, creating a situation where circumstances unique to a particular area are not always known by the employee reviewing the OIC. Also, the IRS now returns OICs as not processable when submitted by taxpayers who have not filed all necessary tax returns, instead of holding on to them for a period as leverage for the taxpayer to cure the filing defects. In conjunction, the IRS now keeps the payments sent with OICs it returns for lack of filing compliance. Taxpayers may face additional difficulties because OICs returned in error are no longer subject to the 24-month acceptance period in IRC § 7122(f) and, processing time is so long, some taxpayers lose two years of refunds as part of their OIC agreement. All of these obstacles could explain why the acceptance rate for individual OICs is at just 44 percent while business OICs have an even lower acceptance rate of 24 percent.

Analysis

In 2018, TAS Research reviewed business OICs and determined that the IRS is losing revenue collection opportunities because of inflated reasonable collection potential (RCP) calculations. In about 40 percent of the business OICs that were not accepted, the OIC amounts offered were much higher than the amounts ultimately collected. Additionally, in fiscal year (FY) 2017, the IRS returned 2,767 individual OICs because of unfiled returns. Of those returned OICs, approximately 34 percent resubmitted an OIC. The IRS returned 561 business OICs because of unfiled returns in FY 2017. Of those returned OICs, approximately 47 percent resubmitted OICs. These numbers indicate that, if the IRS worked with taxpayers to perfect OICs prior to rejection, it might obtain even more returns and would not impose an additional Tax Increase Prevention and Reconciliation Act (TIPRA) payment on these taxpayers.

Recommendations

The National Taxpayer Advocate recommends that the IRS have at least one OIC Specialist in each state to ensure a more even geographic presence for OIC analysis; change its policy for deeming OICs not processable if the taxpayer is not current with his or her filing requirement and reinstate the requirement to retain the OIC and contact taxpayers to discuss obtaining missing returns; reconsider its determination that OICs returned or withdrawn in error are not subject to the 24-month deemed acceptance period in IRC § 7122(f); limit the number of refunds that can be offset while an OIC is pending to one refund only; and conduct a study to analyze the OIC amount offered and collected amount to understand why the IRS is rejecting OICs that have an offered amount greater than the dollars collected.

MSP #19 PRIVATE DEBT COLLECTION: The IRS's Expanding Private Debt Collection Program Continues to Burden Taxpayers Who Are Likely Experiencing Economic Hardship While Inactive PCA Inventory Accumulates

Problem

The IRS implemented its current Private Debt Collection (PDC) initiative in April 2017. As of September 13, 2018, about $5.7 billion in debts of more than 600,000 taxpayers were in the hands of private collection agencies (PCAs). As of September 30, 2018, more than 400,000 taxpayers' debts were in Private Collection Agency (PCA) inventory with no installment agreement (IA) or payment for more than three months after assignment, and had been in PCA inventory for 244 days on average. Thus, PCA inventory is fast becoming a substitute of the IRS collection queue.

PDC program revenues in fiscal year (FY) 2018 surpassed program costs, but this surplus was achieved, to a significant extent, by collecting from financially vulnerable taxpayers. According to IRS databases that contain information from tax returns filed by taxpayers and reports of income filed by third parties:

- 40 percent of taxpayers who entered into IAs while their debts were assigned to PCAs had incomes at or below their allowable living expenses (ALEs);
- 44 percent of taxpayers who made payments while their debts were assigned to PCAs (a group that includes recipients of Social Security Disability Insurance (SSDI) income) had incomes at or below 250 percent of the federal poverty level;
- 37 percent of taxpayers who entered into IAs while their debts were assigned to PCAs defaulted, a frequency that rises to 44 percent when defaulted IAs that PCAs do not report to the IRS as required are taken into account, while the overall default rate for streamlined IAs for taxpayers whose debts are not assigned to PCAs is 19 percent; and
- 34 percent of the amount paid that was attributable to PCA activity was made by taxpayers whose incomes were at or below their ALEs.

The PDC program revenues for fiscal year (FY) 2018, $75 million, are not at the level Congress expected for FY 2018 ($470 million) or even the level expected for FY 2017 ($374 million). Moreover, IRS collection activity with respect to taxpayers whose debts were assigned to PCAs actually generated more dollars for the public fisc in FY 2018 ($37.4 million) than did PCA activity ($25.8 million).

Analysis

Internal Revenue Code § 7122(d) requires the IRS to develop ALE guidelines; if the ALE standards exceed a taxpayer's income, the IRS believes the taxpayer is unable to pay his or her necessary living expenses. For taxpayers whose debts are assigned to PCAs, the congressionally-mandated ALE guidelines for analyzing their ability to pay and evaluating collection alternatives are disregarded because PCAs do not collect financial information from taxpayers. In addition to assigning the liabilities taxpayers who did not dispute their liability, by the end of FY 2018, the IRS had assigned over 150,000 more complex cases, involving assessments: based on substitutes for returns; pursuant to the Automated Underreporter (AUR) computer matching system; or where the taxpayer did not respond, or stopped responding, to IRS inquiries pursuant to an audit. These types of cases are subject to reconsideration and have an increased risk that all or part of the liability may not be owed, so that abatement would be appropriate, including penalty abatement.

Recommendations

The National Taxpayer Advocate recommends that the IRS exclude from assignment to PCAs the debts of taxpayers whose incomes are at or below their ALEs, and the debts of SSDI and Supplemental Security Income (SSI) recipients. The IRS should adjust PCA procedures to: require IRS review of cases in which taxpayers made two or more payments that did not fully pay the liability and were not made pursuant to an IA; require PCAs to return to the IRS cases in which the taxpayer entered into an IA but made no payments for 120 days thereafter; and require return to the IRS cases in which the taxpayer did not enter into an IA and did not make any payments within six months of assignment.

THE LITIGATION STAGE: Access to Representation

MSP #20 PRE-TRIAL SETTLEMENTS IN THE U.S. TAX COURT: Insufficient Access to Available *Pro Bono* Assistance Resources Impedes Unrepresented Taxpayers From Reaching a Pre-Trial Settlement and Achieving a Favorable Outcome

Problem

Taxpayers unable to afford representation to defend against a potential IRS assessment or collection action may believe there are only two courses of action: do nothing, or proceed unrepresented. When it comes to civil justice problems involving money or housing, poor households are twice as likely to do nothing than moderate-income households, according to legal scholars. For over 20 years, Tax Court judges have steadfastly supported programs to bring together unrepresented litigants and representatives offering *pro bono* assistance. Despite broad-based institutional support for these programs, and high rates of same-day resolution for attendees, taxpayer participation rates remain inconsistent. The National Taxpayer Advocate is concerned efforts to provide unrepresented petitioners access to free, competent advice are being undercut and underused because of ineffective outreach and lack of consistent guidance between the IRS Chief Counsel and *pro bono* representatives which undermine the taxpayers' *rights to be informed*, *to retain representation*, and *to a fair and just tax system*, and increases the burden on the Tax Court.

Analysis

The U.S. Tax Court is the only prepayment judicial forum for taxpayers to resolve their disputes with the IRS. More than 80 percent of cases in Tax Court are brought by unrepresented taxpayers, and that percentage increases to almost 94 percent among cases where the deficiency for a tax year is $50,000 or less and the taxpayer elects small tax case (S Case) procedures. We identified the following challenges affecting unrepresented taxpayers' ability to consult with *pro bono* counsel and resolve cases pre-trial: confidentiality restrictions that limit communication with unrepresented taxpayers about *Pro Bono* Day and other pre-trial resolution events by local Low Income Taxpayer Clinics (LITCs) and TAS; limited availability of easily accessible but private meeting spaces for taxpayers experiencing difficulties with security and building access, and *pro bono* resolution events scheduled outside of regular business hours; insufficient staffing and unavailability of interpreter services at *Pro Bono* Days and other pre-trial resolution events; and inadequate coordination of events reducing opportunities to offer one-stop resolution options for unrepresented petitioners. When unrepresented taxpayers have better access to *pro bono* assistance, it eases burden on the Tax Court and IRS Counsel, and can help taxpayers avoid procedural errors and achieve a better outcome in their case.

Recommendations

The National Taxpayer Advocate recommends that the IRS adopt alternative methods for communicating with unrepresented Tax Court petitioners, including working with the Tax Court to modify the petition form to allow taxpayers to consent to direct contacts from local LITCs and TAS; hold more events to encourage pre-trial resolution in easily accessible but private locations and schedule the events outside of regular business hours as necessary; provide staffing at *Pro Bono* Days and other pre-trial resolution events that can provide interpreting services; and develop one-stop resolution options for *pro se* petitioners at *Pro Bono* Days and other pre-trial resolution events to include representatives from Appeals, Collection, and TAS, along with inviting local LITC or Bar Association volunteers or staff and assigning counsel attorneys from the same locality.

STATUS UPDATE

APPEALS: Appeals Has Taken Important Steps Toward Increasing Campus Taxpayers' Access to In-Person, Quality Appeals, But Progress Still Remains to be Made

Problem

To its credit, Appeals, responding to the urgings of the National Taxpayer Advocate and other stakeholders, has recently changed its policy and reinstituted the right of campus taxpayers to transfer their cases to field offices in order to accommodate an in-person conference. We applaud Appeals' taking this important step. Notwithstanding this progress, campus taxpayers continue to receive demonstrably different treatment from that afforded to field taxpayers. The cases of campus taxpayers are assigned to less experienced Appeals Technical Employees (ATEs) who, in most cases, lack familiarity with the issues prevailing in the taxpayer's community. By contrast, field taxpayers have access to more highly graded ATEs who often share taxpayers' local circumstances. This disparate treatment is concerning enough, but the inequality is exacerbated by the circumstance that campus cases generally involve low and middle income taxpayers, who are less able to navigate the Appeals process or advocate factual or legal positions than higher income taxpayers, who typically have their cases assigned to Appeals field offices.

Analysis

Over time, Appeals has sought to consolidate cases into its six campus locations. As a result, its field offices have dropped from 93 to 67 between fiscal year (FY) 2003 and FY 2018, and 53 percent of all Appeals cases are now assigned to the campuses. Moreover, because of the criteria utilized in allocating cases between campus and field offices, a significant income disparity exists between the taxpayer groups channeled to the two venues. Specifically, for FY 2018 the median adjusted gross income (AGI) of field taxpayers was 33 percent higher than that of campus taxpayers, while the mean AGI of field taxpayers was 156 percent higher than that of campus taxpayers. Albeit unintentionally, Appeals systematically provides upper income taxpayers with a higher-quality appeal than that furnished to low and middle income taxpayers. This unequal treatment presents due process concerns that challenge Appeals' ability to undertake effective administrative dispute resolution.

Conclusion

Appeals has taken an important first step in remedying the treatment disparity between higher and lower income taxpayers, but progress remains to be made toward ensuring that all taxpayers have access to a quality appeal. As a result, the National Taxpayer Advocate continues to encourage Appeals to utilize attrition and other strategies as a means of staffing local Appeals offices so as to have at least one permanent Appeals office in every state, the District of Columbia, and Puerto Rico. Additionally, in conjunction with TAS, Appeals should continue exploring ways of adapting facilities or implementing other approaches to accommodate in-person conferences for taxpayers who prefer to have their cases remain in a campus location.

LEGISLATIVE RECOMMENDATIONS

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

The National Taxpayer Advocate places a high priority on working with the tax-writing committees and other interested parties to try to resolve problems encountered by taxpayers. In addition to submitting legislative proposals in each Annual Report, the National Taxpayer Advocate meets regularly with members of Congress and their staffs and testifies at hearings on the problems faced by taxpayers to ensure that Congress considers a taxpayer perspective.

LR #1 IT MODERNIZATION: Provide the IRS with Additional Dedicated, Multi-Year Funding to Replace Its Antiquated Core IT Systems Pursuant to a Plan that Sets Forth Specific Goals and Metrics and Is Evaluated Annually by an Independent Third Party

Problem

The IRS's core information technology (IT) systems are among the oldest in the federal government, limiting the agency's capabilities in significant ways. Partly due to historic poor planning and execution and partly due to lack of funding, the IRS has been unable to replace these antiquated systems. Every year, instead, the agency layers more and more applications and smaller systems onto its core systems. On April 17, 2018, the filing deadline for filing 2017 federal income tax returns, an IRS systems crash prevented taxpayers from electronically submitting their tax returns and payments. The damage from the crash was limited because the IRS gave taxpayers an extra day to file and pay. However, the crash had the effect of creating significant confusion and anxiety among taxpayers and their preparers, and it served as an important wake-up call and a warning of future problems if the IRS is unable to replace its legacy systems soon.

Analysis

Since 2009, the IRS has been taking steps to replace its 1960-era Individual Master File (IMF) system with a system known as the Customer Account Data Engine 2 (CADE 2). Its goal is to transition the IMF's functionality and data to CADE 2 and enable the IRS to retire the IMF. To date, the IRS has not been able to complete this transition. Moreover, it has not been able to make comparable progress in retiring the Business Master File system (which is the authoritative source of individual *business* taxpayer accounts) or several other key legacy systems.

Continuing to rely on these antiquated systems is akin to ignoring a ticking time bomb. By analogy, the IRS has erected a 50-story office building on top of a creaky, 60-year-old foundation, and it is adding a few more floors every year. There are inherent limitations on the functionality of a 60-year-old infrastructure, and at some point, the entire edifice is likely to collapse. Moreover, even apart from the risk of complete collapse, the absence of modern IT systems prevents the IRS from doing its job as effectively as it could on a daily basis. The result is that taxpayers are harmed, practitioners are inconvenienced, and the IRS is hampered in delivering on its mission to provide U.S. taxpayers top quality service and apply the tax law with integrity and fairness to all.

Recommendation

Provide the IRS with additional dedicated, multi-year funding to replace its core legacy IT systems pursuant to a plan that sets forth specific goals and metrics and is evaluated annually by an independent third party.

LR #2 ADMINISTRATIVE APPEAL RIGHTS: Amend Internal Revenue Code Section 7803(a) to Provide Taxpayers With a Legally Enforceable Administrative Appeal Right Within the IRS Unless Specifically Barred by Regulations

Problem

Congress has long understood the importance of an independent Appeals function within the IRS as a means of facilitating case resolutions and minimizing litigation, which is burdensome to both taxpayers and the government. Accordingly, Congress mandated that the IRS Office of Appeals (Appeals) be an independent function within the IRS as part of the IRS Restructuring and Reform Act of 1998. Appeals, however, is unable to perform its intended role when its jurisdiction is curtailed by various means, such as precipitous issuance of statutory notices of deficiency or designating cases for litigation on the grounds of "sound tax administration." Currently, the IRS can bypass Appeals at will because taxpayers have no such right under the law.

Analysis

Access to Appeals is important for a variety of reasons, including Appeals' ability to accept affidavits and weigh oral testimony, consider hazards of litigation, and apply the *Cohan* rule as a means of negotiating a case resolution. Further, Appeals' role in fair and equitable tax administration was recognized by the Taxpayer Bill of Rights (TBOR) of IRC § 7803(a)(3), which, among other things, spoke of taxpayers' *right to appeal an IRS decision in an independent forum*. The U.S. District Court for the Northern District of California recently weighed in on the scope of taxpayers' right to an administrative appeal in *Facebook, Inc. v. IRS*. That case considered a scenario where, after an extended IRS audit, Facebook requested an administrative appeal, which the IRS ultimately prevented on the grounds of sound tax administration. The District Court ruled in favor of the IRS, explaining that taxpayers have no enforceable right to an appeal. Nevertheless, the lack of such recourse is highly problematic because an appeal represents the final administrative opportunity to resolve a case without resort to litigation. Further, the Office of Appeals is the only IRS function that attempts to act independently of other agency determinations and to provide taxpayers with an unbiased forum for negotiating case settlements. The IRS therefore should not be able to deprive taxpayers of an administrative appeal on an *ad hoc* basis.

Recommendations

The National Taxpayer Advocate recommends that Congress amend section 7803(a) to establish an independent Office of Appeals and grant taxpayers the right to a prompt administrative appeal within the IRS that provides an impartial review of all compliance actions and an explanation of the Appeals decision, except where the Secretary has determined, pursuant to regulations, that an appeal is not available, including on the basis of designation for litigation or adoption of a frivolous position. Where an appeal is not available, the Secretary shall furnish taxpayers with the procedures for protesting to the Commissioner the decision to bar an appeal in these circumstances.

LR #3 FIX THE *FLORA* RULE: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can

Problem

It can be difficult or impossible for some taxpayers to obtain judicial review of what the IRS says they owe, especially low income taxpayers and those subject to "assessable" penalties (*i.e.*, penalties that can be assessed without first giving the taxpayer a notice of deficiency). Before assessing certain liabilities, the IRS must issue a "notice of deficiency," which gives the taxpayer an opportunity to petition the U.S. Tax Court. However, a TAS study found that when the IRS sent an audit notice to those claiming the Earned Income Tax Credit (EITC)—a refundable tax credit for the working poor—almost 40 percent did not understand what the IRS was questioning and only about half of the respondents felt that they knew what they needed to do. Thus, many are unlikely to understand whether and how to timely petition the Tax Court in response to a notice of deficiency. Moreover, the IRS can assess other liabilities (*e.g.*, assessable penalties) without issuing a notice of deficiency.

An alternative is for the taxpayer to pay the disputed assessment in full, file a claim for refund with the IRS, and if that claim is denied or not acted upon within six months, file a refund suit in a U.S. District Court or the U.S. Court of Federal Claims. In 1960, however, the Supreme Court held in *Flora* that with limited exceptions a taxpayer must have "fully paid" the assessment (called the "full payment rule") before suing in these courts. Accordingly, taxpayers who are wealthy enough to fully pay can access these courts, whereas poor taxpayers and others subject to unreasonably large assessments are generally out of luck. Even if they can pay over time (*e.g.*, through an installment agreement or refund offsets), other rules often bar taxpayers from recovering amounts that they paid more than two years before they made the refund claim.

In theory, some taxpayers can get their cases reviewed if the IRS issues levies or liens to collect the assessment and they appeal the result of a Collection Due Process (CDP) determination to the Tax Court. However, no such judicial review is available if the IRS only collects by offsetting refunds or if the IRS gives the taxpayer an opportunity for an *administrative* appeal. Similarly, some taxpayers can get their cases reviewed by a bankruptcy court, but only if they enter bankruptcy and even then, generally only if the review would benefit their creditors. Thus, neither CDP nor bankruptcy procedures ensure access to judicial review.

Analysis

The *Flora* Court's decision said a policy basis for the full payment rule was to protect the "public purse" and cited earlier decisions that said the rule was needed to protect the very "existence of government" from a "hostile judiciary." However, the government has never depended on assessable penalties to survive, and it is unlikely that the full payment rule even protects the public purse. Revenue concerns subsided after 1913 when the 13th Amendment expressly authorized the income tax and again in 1942 when Congress broadened the tax base, reducing the risk that a significant percentage of the tax base would sue instead of paying. Indeed, Congress must not have been concerned about threats to the existence of government by 1924 when it granted the Tax Court jurisdiction for pre-payment reviews, and by 1998 when it expanded this jurisdiction to CDP appeals. Furthermore, if providing the poor and those facing large liabilities with less due process when taking their property reduces the perceived fairness of the tax system, the full payment rule could reduce voluntary compliance and reduce government revenues.

While an original justification for the full payment rule has faded, the problems it poses have grown. In 1960 when *Flora* was decided, there were only four assessable penalties, but today there are over 50. Moreover, the EITC was not enacted until 1975. It brought the working poor into the tax system by giving them tax benefits. Thus, the full payment rule increasingly erodes the *right to appeal an IRS decision in an independent forum* by those who were not a part of the tax system in 1960.

Recommendations

If Congress does not repeal the full payment rule, it should consider treating a taxpayer as having fully paid a disputed amount when he or she has paid some of it (including by refund offset) and (a) the IRS has classified the account as currently not collectible due to economic hardship or (b) the taxpayer has entered into an agreement to pay the liability in installments. Congress could address the problem of assessable penalties by (1) clarifying that the full payment rule only applies in cases where the taxpayer has received a notice of deficiency, (2) authorizing the Tax Court to review liabilities that can be assessed without a notice of deficiency in a manner that parallels the deficiency process, or (3) expanding the Tax Court's jurisdiction to review liabilities in connection with CDP appeals, even if the taxpayer has had an opportunity for an *administrative* appeal.

LR #4 INNOCENT SPOUSE RELIEF: Clarify That Taxpayers May Raise Innocent Spouse Relief In Refund Suits

Problem

Under IRC § 6015(e), the United States Tax Court (the Tax Court) has jurisdiction to review the IRS's denials of requests for innocent spouse relief. Even though taxpayers' right to petition the Tax Court under IRC § 6015(e) is "in addition to any other remedy provided by law," in 2018 a federal district court refused to consider a taxpayer's innocent spouse claim in a refund suit arising under IRC § 7422. Other district courts have allowed the claim in refund suits for decades. The court's refusal to allow a taxpayer to request innocent spouse relief in a refund suit may:

- Deprive taxpayers of their right to a jury trial; and
- Deprive a successful taxpayer who makes a deposit to suspend the accrual of interest of overpayment interest he or she would otherwise receive.

Analysis

A taxpayer may seek Tax Court review of the IRS's denial of innocent spouse relief without first paying an asserted deficiency, but there is no right to a jury trial in Tax Court. A taxpayer who obtains innocent spouse relief in Tax Court may be entitled to a refund to the extent permitted by IRC § 6015(g). Interest on any refund would be payable at the rate of three percentage points above the federal short-term rate. A taxpayer may, without waiting for the outcome in Tax Court, make a deposit to suspend the accrual of interest and penalties while Tax Court proceedings are pending. The deposit will be returned to the successful taxpayer with interest at the federal short-term rate.

Alternatively, a taxpayer may pay the asserted tax and request a refund from the IRS, which also suspends the accrual of interest and penalties. If the IRS denies the claim, the taxpayer may seek a refund in the United States district courts, where a jury trial is available, or in the United States Court of Federal Claims. The successful taxpayer's overpayment is refunded with interest at the rate of three percentage points above the federal short-term rate.

A district court's refusal to consider innocent spouse claims in refund suits leaves taxpayers with only one forum—the Tax Court—in which to seek review of the IRS's decision to deny their claims. Thus, taxpayers' right to a jury trial is circumvented and taxpayers who are willing to pay the asserted liability prior to litigation must forego three percentage points of interest. They cannot seek a refund in a district court (where any refund would be paid with interest at the federal short-term rate plus three percentage points), but may make a deposit pending the outcome in the Tax Court (which would be repaid with interest at the short-term federal rate).

Recommendation

Amend IRC §§ 6015 and 66 to clarify that taxpayers are entitled to raise innocent spouse relief in refund suits arising under IRC § 7422.

LR #5 TAX COURT JURISDICTION: Fix the Donut Hole in the Tax Court's Jurisdiction to Determine Overpayments by Non-Filers with Filing Extensions

Problem

Taxpayers who overpay their taxes by the original due date of their tax return and then request a six-month filing extension, but for whatever reason, do not file a return before the IRS sends a notice of deficiency are not getting the benefit of a special rule, which was supposed to allow the United States Tax Court to determine their overpayment (assuming they timely contest the notice of deficiency). A taxpayer who timely pays his taxes and files a return can generally recover overpayments made with the original return for three years (plus any period of extension of time for filing). Under the general rule, non-filers can recover payments made up to two years before the date of their claims. Under a special rule in section 6512(b), these non-filers were supposed to get an extra year if the IRS sent them a notice of deficiency before they filed a return. The special rule was supposed to treat them like taxpayers who had filed their return on the date the IRS sent the notice of deficiency.

In the *Borenstein* case, however, the Tax Court concluded that it had no jurisdiction to determine an overpayment or refund under the special rule because the taxpayer had requested a six-month extension to file. The IRS had mailed the notice of deficiency during the first six months of the third year following the original due date—*after* the second year following the due date without extensions (*i.e.*, after expiration of the general two-year period) and *before* the third year following the due date *with extensions* (*i.e.*, the beginning of the period covered by the special rule). Because the general rule focuses on filing deadlines *without regard to extensions*, and the special rule focuses on filing deadlines *with regard to extensions*, there is a six-month gap or "donut hole" between these two periods for taxpayers who request filing extensions but who do not file before the IRS issues a notice of deficiency.

Analysis

Legislative history makes clear that Congress intended to enact a special rule that allows the Tax Court to determine overpayments "paid within the 3-year period prior to the date of the deficiency notice" when nonfilers "receive a notice of deficiency and file suit to contest it in Tax Court during the third year after the return due date." The statute does not work as intended. This glitch may only affect taxpayers who request a six-month filing extension and then, for whatever reason, do not file a return. Because Congress felt it was important enough to provide non-filers with this special rule, however, the National Taxpayer Advocate believes it is important to highlight this unintended result and recommend a solution.

Recommendation

Clarify that when the IRS mails a notice of deficiency after the second year following the due date of the return (*without regard to extensions*) and before the taxpayer files a return, the taxpayer can recover payments made within three years after the due date of the return (*without regard to extensions*).

LR #6 INTERGOVERNMENTAL AGREEMENTS (IGAS): Amend Internal Revenue Code § 1474 to Allow a Period of Notice and Comment on New IGAs and to Require That the IRS Notify Taxpayers Before Their Data Is Transferred to a Foreign Jurisdiction Pursuant to These IGAs, Unless Unique and Compelling Circumstances Exist

Problem

The Foreign Account Tax Compliance Act (FATCA) generally requires foreign financial institutions (FFIs) to provide the U.S. with information regarding foreign accounts held by U.S. taxpayers. Typically, this information exchange occurs via intergovernmental agreements (IGAs), under which FFIs furnish the information to their local tax authority, which in turn transfers it to the U.S. These IGAs also generally incorporate reciprocity, pursuant to which the U.S. agrees to provide the foreign jurisdiction with information regarding its citizens or residents maintaining accounts in the U.S. Nevertheless, the IRS is exchanging U.S. taxpayer information under circumstances where it cannot ensure that the data is used properly by IGA partners and where the data transfers to foreign recipients do not conform to guidelines established by the National Institute of Standards and Technology (NIST).

Analysis

The IRS has identified the risks inherent in its data transfers to IGA partners, but has determined that these risks are acceptable. The data being disclosed and potentially breached, however, relate to taxpayers, not to the IRS. Taxpayers, rather than the IRS, are exposed to the consequences of data theft or misuse potentially arising during or after information transfers to foreign partners pursuant to IGAs. They could, among other things, be the victims of identity theft or the targets of persecution within foreign jurisdictions, with outcomes ranging from substantial inconvenience to serious economic damage to harassment and even physical danger. Currently, however, taxpayers have no voice in these IGAs and receive no specific notification that their personal information is being transferred outside of U.S. jurisdiction. If informed that IGA negotiations or data transfers were pending, taxpayers would have an opportunity to provide the U.S. government with potentially important information and minimize risks to their property and physical safety.

Recommendation

The National Taxpayer Advocate recommends that Congress amend Internal Revenue Code (IRC) § 1474 to add IRC § 1474(g)(1), requiring the public announcement of intergovernmental agreements for notice and comment by taxpayers; IRC § 1474(g)(2), requiring that, as part of this announcement, the IRS specify the extent to which the proposed IGA partner jurisdiction complies with the cybersecurity standards to which U.S. federal agencies are held and the taxpayer privacy standards which govern the IRS; and IRC § 1474(g)(3), requiring that, barring unique and compelling circumstances, taxpayers be informed prior to the transfer of their individual information pursuant to the terms of an IGA.

LR #7 FOREIGN ACCOUNT REPORTING: Authorize the IRS to Compromise Assessed FBAR Penalties It Administers

Problem

Although the IRS has the authority to compromise tax liabilities assessed under the Internal Revenue Code (IRC), which fall under Title 26 of the U.S. Code, it currently does not have the authority to compromise assessed Foreign Bank and Financial Accounts (FBAR) penalties, which fall under Title 31 of the U.S. Code. Assessed FBAR penalties which exceed $100,000 can only be compromised by the Department of Justice (DOJ) while those under that amount can be compromised by the Bureau of Fiscal Service (BFS). However, despite the lack of ability to compromise on Title 31 penalties, the IRS has been delegated the authority to enforce and assess FBAR penalties by the Financial Crimes Enforcement Network (FinCEN). Therefore, when the IRS assesses both Title 26 tax penalties under the IRC and Title 31 FBAR penalties stemming from the same conduct, and it considers an offer in compromise (OIC) for the tax liabilities, the IRS cannot consider compromising the assessed Title 31 FBAR penalties to achieve a comprehensive resolution for the taxpayer. The taxpayer must still go to BFS or DOJ to compromise on the remaining debt he or she owes.

Analysis

Affected taxpayers need to complete multiple steps to compromise all liabilities (FBAR and tax), and deal with two or sometimes three different government agencies, which increases taxpayer burden not limited to costs of representation and undermines the taxpayer's *rights to finality* and *to a fair and just tax system*. This process is also inefficient for the government as it may create rework at different stages for several government agencies—the IRS, BFS, and DOJ. This legislative change would not create a conflict with the statutory framework for compromise of nontax debts under 31 U.S.C. § 3711. For Title 26 tax liabilities, IRC § 7122 currently authorizes the IRS to compromise any civil or criminal penalties assessed in cases arising under the Internal Revenue laws prior to referral of the case to DOJ. Similarly, if adopted, this legislative change would authorize the IRS to compromise Title 31 FBAR penalties it has assessed but only prior to referral of the case to DOJ. DOJ would retain jurisdiction to compromise both tax and nontax (FBAR penalty) liabilities after a case is referred to it by the IRS.

Recommendation

The National Taxpayer Advocate recommends that Congress amend IRC § 7122(a) to allow the IRS to compromise the FBAR penalties assessed by the IRS under U.S.C. Title 31.

LR #8 TAX WITHHOLDING AND REPORTING: Improve the Processes and Tools for Determining the Proper Amount of Withholding and Reporting of Tax Liabilities

Problem

The U.S. tax system requires employers to undertake pay-as-you-earn (PAYE) withholding on wages earned by employees. This approach creates significant concerns regarding privacy and complexity because, unlike in many other countries, the U.S. system forces employees to navigate an often-confusing and difficult process to provide employers with their personal information, including other sources of income and marital status, so that the correct amount of tax can be withheld. This effort is made even more challenging by the circumstance that, in the U.S., PAYE applies primarily to wage income, thereby significantly limiting the pool of earnings from which annual tax liabilities can be collected during the year. As a related difficulty, taxpayers cannot readily access their own tax return information and are provided with inadequate tools for preparing and filing free electronic tax returns.

Analysis

Concerns regarding employee privacy and taxpayer burden can be addressed by channeling withholding information through the IRS rather than through employers. For example, in New Zealand, taxpayers complete an anonymous questionnaire and are provided by the tax authority with a withholding code that they then furnish to their employers. This approach preserves employee privacy, minimizes complexity, and decreases the risk of data breaches. Likewise, greater accuracy in the collection of tax at source can be achieved through expanding the income types on which withholding is undertaken. For instance, the U.K. withholds on a range of income, including wages, royalties, pensions, and annuities, which enables approximately two-thirds of U.K. taxpayers to end each year having already fully and accurately satisfied their tax liabilities. The U.S. could achieve similar results by increasing PAYE coverage to encompass the seven most common types of income. Further, return filing itself could be simplified by enhancing Free File Fillable Forms such that tax return information could be imported and computations automatically performed.

Recommendation

The National Taxpayer Advocate recommends that Congress enact legislation instructing the Treasury Department, in consultation with the IRS and the National Taxpayer Advocate, to analyze and report on the feasibility of and steps necessary for: adopting an IRS-determined withholding code as an alternative to the Form W-4 approach currently utilized in U.S. tax administration; expanding withholding at source to encompass not only wages, but taxable interest, pensions, dividends, capital gains, IRA income, unemployment, and eventually certain earnings as an independent contractor; and furnishing information return data to taxpayers electronically for direct importation into tax return preparation software or to authorized tax return preparers.

LR #9 INDIAN EMPLOYMENT CREDIT: Amend IRC § 45A to Make the Indian Employment Credit an Elective Credit for Employers Who Hire Native Americans

Problem

In 1993, Congress introduced IRC § 45A, a provision that provides a monetary incentive in the form of a tax credit to employers who hire Native Americans who meet all the requirements of the provision. The Indian Employment Credit (IEC) has been repeatedly extended by Congress, most recently, in February 9, 2018, for all tax years before December 31, 2017. IRC § 45A provides a *mandatory* tax credit based on the wages and employee health insurance costs paid by the employer to qualified employees in the taxable year. However, the IRC § 38(c) limitation and the mandatory nature of IRC § 280C and IRC § 45A can sometimes result in a disincentive for the employer. This outcome, resulting in the employer better off not having hired Native American employees, frustrates the original purpose of the credit.

Analysis

The calculation of the IRC § 45A credit is based upon two factors. First, under IRC § 280C, the taxpayer cannot take a deduction (*e.g.*, through IRC § 162) for the cost of the employment credit. Second, under IRC § 38(c)(1), business credits, such as the IEC, may not exceed the excess (if any) of the taxpayer's net income tax over the greater of either the tentative minimum tax for the taxable year or 25 percent of so much of the taxpayer's net regular tax liability as exceeds $25,000. A 2013 Tax Court case, *Uniband, Inc. v. Commissioner*, provides an example of a situation in which the employer was disadvantaged by being required to take the mandatory IEC. In *Uniband*, the employer took its entire IRC §162 business deduction instead of reducing the deduction and claiming the IEC, which the employer was required to take, because the amount of the IEC the employer was eligible for was limited under the general business credit limitation in IRC §38(c)(1). IRC § 45A only provides an amount determined that becomes a component of what is allowed as a credit by IRC § 38(a). The Tax Court agreed with the IRS's tax adjustment where it applied the limited credit but reduced the taxpayer's IRC §162 deduction by the full amount determined (but not allowed) under IRC § 45A. Data shows that the IEC is mostly claimed by individual taxpayers on the IRS Form 1040. For instance, in tax year 2017, 6,544 individual taxpayers claimed it on Form 1040, compared to 170 estates and trusts, and 455 corporations. Considering the legislative purpose of the IEC to create an incentive to hire Native Americans on Indian reservations, it would make sense to make the credit elective rather than mandatory. That way, in situations in which employers are disadvantaged by taking the credit, they may avoid the disadvantage by electing not to claim it.

Recommendation

If Congress extends IRC § 45A in the future, the National Taxpayer Advocate recommends Congress amend IRC § 45A to make the Indian Employment Credit an elective, rather than mandatory, credit for employers who hire eligible Native American employees.

LR #10 CHILD TAX CREDIT: Amend Internal Revenue Code § 24(c)(1) to Conform With § 152(c)(3)(B) for Permanently and Totally Disabled People Age 17 and Older

Problem

Under Internal Revenue Code (IRC) § 24(c)(1), a qualifying child for the Child Tax Credit (CTC) must generally meet the definition of a qualifying child set forth in IRC § 152(c) with an exception for certain noncitizens and with a different age requirement: the child must not have attained the age of 17. For tax year (TY) 2017 and earlier, taxpayers could claim a dependency exemption for a permanently and totally disabled child as a qualifying child, regardless of age, pursuant to the exception in IRC §152(c)(3)(B) for individuals who are permanently and totally disabled at any time during the calendar year. The Tax Cuts and Jobs Act (TCJA) suspended dependency exemptions for TYs 2018-2025, but provided a $500 credit for other dependents when the dependent does not meet the definition of a qualifying child for the purpose of the CTC. A permanently and totally disabled child, age 17 or older does not qualify for the CTC, and a taxpayer may no longer claim a dependency exemption for the disabled child, which imposes an additional financial burden on families with a permanently and totally disabled child age 17 or older and undermines the *right to a fair and just tax system*.

Analysis

Although the TCJA added a new credit for other dependents of $500 under IRC § 24 and expanded the CTC from up to $1,000 to up to $2,000, it suspended dependency exemptions, leaving taxpayers with a permanently and totally disabled child age 17 or older potentially worse off than under the previous tax law. Compared to families without a permanently and totally disabled child, these families may face higher costs associated with child care, exacerbating the impact of not being able to claim the CTC for their child. TAS reviewed tax returns filed for tax year 2017 and found that approximately 380,000 returns were filed claiming a dependent who was also receiving Social Security Disability Income and was at least 15 years younger than the primary or secondary taxpayer on the tax return. While this information is not a perfect proxy for the number of taxpayers claiming a permanently and totally disabled child age 17 or older as a dependent, (due to the limitations of data the IRS has available) it provides a picture of the number of families who may be impacted by the age limitation of the CTC and the suspension of the dependency exemption for TYs 2018-2025.

Recommendation

Amend the age requirement of IRC § 24(c)(1) to provide that, generally, the term "qualifying child" means a qualifying child (as defined in section 152(c)) of the taxpayer who has not attained age 17 or who meets the exception under IRC § 152(c)(3)(B) (Special rule for disabled).

MOST LITIGATED ISSUES

Internal Revenue Code (IRC) § 7803(c)(2)(B)(ii)(x) requires the National Taxpayer Advocate to include in her Annual Report to Congress the ten tax issues most litigated in the federal courts, classified by the type of taxpayer affected. The cases we reviewed were decided during the 12-month period that began on June 1, 2017, and ended on May 31, 2018.

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

Internal Revenue Code (IRC) § 6662(b)(1) and (2) authorizes the IRS to impose a penalty if a taxpayer's negligence or disregard of rules or regulations causes an underpayment of tax required to be shown on a return, or if an underpayment exceeds a computational threshold called a substantial understatement, respectively. IRC § 6662(b) also authorizes the IRS to impose the accuracy-related penalty on an underpayment of tax in six other circumstances.

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

The deductibility of trade or business expenses has long been among the ten Most Litigated Issues (MLIs) since the first edition of the National Taxpayer Advocate's Annual Report to Congress in 1998. We identified 106 cases involving a trade or business expense issue that were litigated in federal courts between June 1, 2017, and May 31, 2018. The courts affirmed the IRS position in 81 of these cases, or about 76 percent, while taxpayers fully prevailed in only six cases, or about six percent of the cases. The remaining 19 cases, or about 18 percent, resulted in split decisions.

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

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

A person who has a summons served on him or her may contest its legality if the government petitions to enforce it. Thus, summons enforcement cases are different from many other cases described in other Most Litigated Issues because often the government, rather than the taxpayer, initiates the litigation. If the IRS serves a summons on a third party, any person entitled to notice of the summons may challenge its legality by filing a motion to quash or by intervening in any proceeding regarding the summons. Generally, the burden on the taxpayer to establish the illegality of the summons is heavy. When challenging the summons's validity, the taxpayer generally must provide "some credible evidence" supporting an allegation of bad faith or improper purpose. The taxpayer is entitled to a hearing to examine an IRS agent about his or her purpose for issuing a summons only when the taxpayer can point to specific facts or circumstances that plausibly raise an inference of bad faith. Naked allegations of improper purpose are not enough, but because direct evidence of IRS's bad faith "is rarely if ever available," circumstantial evidence can suffice to meet that burden.

TAS identified 85 federal cases decided between June 1, 2017, and May 31, 2018, involving IRS summons enforcement issues. The government was the initiating party in 61 cases, while the taxpayer

was the initiating party in 24 cases. Overall, taxpayers fully prevailed in three cases, while four cases were split. The IRS prevailed in the remaining 78 cases.

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

When preparing tax returns, taxpayers must complete the crucial calculation of gross income for the taxable year to determine the tax they must pay. Gross income has been among the Most Litigated Issues in each of the National Taxpayer Advocate's Annual Reports to Congress. For this report, we reviewed 79 cases decided between June 1, 2017, and May 31, 2018. The majority of cases involved taxpayers failing to report items of income, including some specifically mentioned in Internal Revenue Code (IRC) § 61 such as wages, interest, dividends, and pensions.

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

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

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

We reviewed 47 decisions issued by federal courts from June 1, 2017, to May 31, 2018, regarding additions to tax for:

i. Failure to file a tax return by the due date under Internal Revenue Code (IRC) § 6651(a)(1);

ii. Failure to pay an amount shown on a tax return under IRC § 6651(a)(2);

iii. Failure to pay installments of the estimated tax under IRC § 6654; or

iv. Some combination of the three.

The phrase "addition to tax" is commonly referred to as a penalty, so we will refer to these additions to tax as the failure to file penalty, the failure to pay penalty, and the estimated tax penalty. Twelve cases involved the imposition of the estimated tax penalty in conjunction with the failure to file and failure to pay penalties; 35 cases involved the failure to file or failure to pay penalties without the estimated tax penalty; and there were no cases involving the estimated tax penalty as the only issue.

A taxpayer can avoid the failure to file and failure to pay penalties by demonstrating the failure is due to reasonable cause and not willful neglect. The estimated tax penalty is imposed unless the taxpayer falls within one of the statutory exceptions. Taxpayers were unable to avoid a penalty in 41 of the 47 cases.

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

Internal Revenue Code (IRC) § 7403 authorizes the United States to file a civil action in U.S. District Court against a taxpayer who has refused or neglected to pay any tax, to enforce a federal tax lien, or to subject any of the delinquent taxpayer's property and rights to property to the payment of tax. Unlike cases in other Most Litigated Issues, lien enforcement cases are always initiated by the government through the Department of Justice rather than the taxpayer. We identified 39 opinions issued between June 1, 2017, and May 31, 2018, that involved civil actions to enforce liens under IRC § 7403. The IRS prevailed in 37 of these cases, one case was remanded for additional proceedings, and one case resulted in a split decision. The 39 cases identified for this reporting period represent a 35 percent decrease from the previous year.

MLI #8 Charitable Contribution Deductions Under IRC § 170

Subject to certain limitations, taxpayers can take deductions from their adjusted gross incomes (AGIs) for contributions of cash or other property to or for the use of charitable organizations. To take a charitable deduction, taxpayers must contribute to a qualifying organization and substantiate contributions of $250 or more. Litigation generally occurred in this reporting cycle in the following three areas:

- Substantiation of the charitable contribution;
- Valuation of the charitable contribution; and
- Requirements for a qualified conservation easement.

TAS identified and reviewed 29 cases decided between June 1, 2017, and May 31, 2018, with charitable deductions as a contested issue. The IRS prevailed in 24 cases, taxpayers prevailed in four cases, and the remaining case resulted in a split decision. Taxpayers represented themselves (appearing *pro se*) in 10 of the 29 cases (34 percent), and the IRS prevailed fully in all ten cases.

MLI #9 Itemized Deductions Reported on Schedule A (Form 1040)

For the first time since the National Taxpayer Advocate's Annual Report to Congress in 2002, itemized deductions reported on Schedule A of IRS Form 1040 are among the ten Most Litigated Issues. We identified 23 cases involving itemized deductions that were litigated in federal courts between June 1, 2017, and May 31, 2018. The courts affirmed the IRS position in 16 of these cases, or about 70 percent, while taxpayers fully prevailed in four cases, or about 17 percent of the cases. The remaining three cases, or about 13 percent, resulted in split decisions.

MLI #10 Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

From June 1, 2017, through May 31, 2018, the federal courts issued decisions in at least 19 cases involving the Internal Revenue Code (IRC) § 6673 "frivolous issues" penalty, and in at least three cases involving analogous penalties at the appellate level. These penalties are imposed for maintaining a case primarily for delay, raising frivolous arguments, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal. In many of the cases we reviewed, taxpayers escaped liability for the penalty but were warned they could face sanctions for similar conduct in the future. Nonetheless, we included these cases in our analysis to illustrate what conduct will and will not be tolerated by the courts.

VOLUME 2

TAS RESEARCH AND RELATED STUDIES

#1 A Conceptual Analysis of Pay-As-You-Earn (PAYE) Withholding Systems As a Mechanism for Simplifying and Improving U.S. Tax Administration

Pay-as-you-earn (PAYE) systems are designed to collect the correct amount of tax throughout the course of the year as taxpayers earn the associated income. The U.S. has a simple PAYE system, which applies withholding predominantly on wage income. By contrast, other countries, such as the United Kingdom (U.K.) and New Zealand, have a broader PAYE system collecting tax on a range of payments beyond simple wages. The U.K. has been so successful at this expansion that approximately two-thirds of British taxpayers end each year having already fully and accurately satisfied their tax liabilities.

This study considers the benefits and burdens of an expanded PAYE system within the U.S. and the challenges that would need to be addressed in order for this expansion to occur. Both taxpayers and the IRS would benefit from a broader PAYE system. From the perspective of taxpayers, an expanded PAYE tax system combined with real-time adjustments based on taxpayers' changing circumstances would allow for a much more accurate collection of tax liabilities at source throughout the course of the year. In theory, by year end, most taxpayers would be neither over-withheld nor under-withheld and would have enjoyed the benefits of this relative certainty during the entire year. Moreover, the overall reporting and payment system would be simplified and the possibility of unintentional errors reduced. An expanded PAYE also would streamline and improve tax administration. As the liabilities of most taxpayers would be determined and collected in real time, the IRS would be spared the resource burdens inherent in after-the-fact collection endeavors. Moreover, they would be obtaining the tax remittances and much of the relevant information from third parties, thereby substantially reducing opportunities for intentional noncompliance.

In tax year (TY) 2016, 45 percent of nonitemizing filings reported wage earnings subject to withholding as the sole source of income. Thus, even simple PAYE allows for complete withholding of tax at source for these approximately 59 million filings. With a variety of withholding adjustments, some involving a greater or lesser degree of difficulty, PAYE tax collection could be extended to seven of the primary income sources, covering 62 percent of tax returns.

Additionally, for a comprehensive PAYE system to provide relatively accurate levels of withholding, that system must properly account for frequently occurring deductions and credits. Such is particularly the case if the PAYE system is ever to form the basis of a return-free filing regime for substantial numbers of taxpayers. The inclusion of these tax benefit items, particularly refundable credits such as the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC), is easier said than done. However, a comprehensive real-time PAYE system that included the above income types along with the seven most popular deductions and credits would cover 51 percent of tax returns. More modestly, a PAYE system incorporating only wage, interest, pension, and dividend income and solely the standard deduction would still achieve relatively accurate annual withholding for 26 percent of tax returns.

Regardless of the income, deduction, and credit items ultimately included, substantial PAYE coverage in the U.S. will require that significant procedural and cultural obstacles be confronted and overcome.

Specifically, when expanding PAYE, some systemic features of the U.S. tax regime could be utilized, but many would need to be adjusted. Among other things:

- Information reporting mechanisms already exist with respect to the primary income types, which could be leveraged in a PAYE system.
- Expanded withholding requirements would impose burdens on impacted withholding agents. These burdens would need to be minimized and potentially subsidized.
- Coverage of independent contractors within the PAYE system would represent a significant step along the comprehensiveness spectrum.
- The ability to administer refundable credits, such as the EITC and the CTC, in conjunction with a PAYE system also would substantially broaden its potential scope. Nevertheless, the scale of systemic and cultural changes needed to accommodate these credits as part of, or alongside, PAYE, cannot be overstated.
- More robust real-time reporting is an essential aspect of any comprehensive PAYE system.
- Use of a PAYE code facilitates the efficiency of PAYE regimes.

Equally important as the technical ability to implement PAYE is taxpayers' willingness to accept it. Among other things:

- Taxpayers may find the expanded responsibility of the IRS under a PAYE system to be disconcerting.
- Sharing additional personal information with employers could raise significant privacy concerns.
- Taxpayers are often unwilling or unable to interact with the IRS on an ongoing basis.
- Tax refunds, which would be minimized by PAYE, are highly valued by many taxpayers and impact local and national economies.

To the extent that these technical and cultural issues can be accommodated, either in whole or in part, both U.S. taxpayers and the IRS have much to gain from an expanded PAYE system. As a result, the National Taxpayer Advocate recommends that the IRS and Treasury collaborate with TAS to:

- Study the feasibility of, and options for, establishing a real-time comprehensive PAYE system. The study should focus first on applying such a system to income attributable to wages, interest, pensions, and dividends, and the standard deduction, which would cover approximately 26 percent of tax returns, and should consider the incremental costs and benefits of adding each category to a real-time comprehensive PAYE system. The study should then analyze such an expansion as it would apply to all 14 income, deduction, and credit categories, which would cover 51 percent of tax returns; and
- Conduct a public opinion survey examining the receptivity of potentially impacted taxpayers to a real-time comprehensive PAYE system, the changes in behavior it would require, and the results it would generate.

#2 A Study of the IRS's Use of the Allowable Living Expense Standards

Internal Revenue Code (IRC) § 7122(d)(2)(A) requires that the IRS "develop and publish schedules of national and local allowances designed to provide that taxpayers entering into a compromise have an adequate means to provide for basic living expenses." However, the statute also allows for deviations. It instructs the IRS to review each taxpayer's situation on a case-by-case basis and not use the Allowable Living Expense (ALE) standards if "such use would result in the taxpayer not having adequate means to provide for basic living expenses."[1] The resulting ALE standards, which represent how much money the IRS believes a taxpayer needs to meet necessary expenses, have come to play a crucial role not just in offer in compromise cases but all types of collection cases. Given how important the ALE standards are to taxpayers who have a tax debt, the National Taxpayer Advocate charged TAS Research with analyzing how well the ALE standards perform in making sure taxpayers have "adequate means to provide for basic living expenses" before paying their tax debt.

TAS Research reviewed financial information received from taxpayers who wanted to enter into installment agreements (IAs). This information was then compared to applicable ALE standards. In nearly two-thirds of the cases reviewed, taxpayers claimed higher expenses in at least one of the ALE categories than was recognized by the ALE standards. The prevalence of the expense being greater than the ALE standard and the frequency of the IRS disallowing the excess expense varied according to expense type.

Fifty-four percent of taxpayers had housing and utility expenses in excess of the ALE standards. And of those, approximately 37 percent had their expenses disallowed. Around 28 percent of taxpayers had national standard expenses (food, clothing, etc.) in excess of the ALE standards but slightly over half of those taxpayers had their expenses disallowed.

Pursuant to statutory direction, internal IRS guidance promotes the use of good judgment in ALE analysis and allows deviations when necessary.[2] Since the total ALE calculation represents what the IRS has determined is necessary for a taxpayer and his or her family to meet all necessary living expenses, TAS Research also considered the prevalence of a particular ALE expense being disallowed for being excessive when in totality the taxpayer's expenses were less than his or her ALE amount. This would indicate the taxpayer is choosing to allocate budget dollars to an expense he or she prioritizes over other categories; that is, the taxpayer is willing to sacrifice in one area to cover other expenses.

Overall, 26.3 percent of the sample taxpayers claimed more than the amount of at least one ALE standard, even though they claimed less than the total amount of all allowable ALE expenses for their specific circumstance. The IRS disallowed expenses greater than those specifically allowed by the ALE standards 28.8 percent of the time. In over 90 percent of these cases, the IRS disallowed the additional expense even though the taxpayer provided documentation.

TAS Research also considered expenses outside of the ALE standards but included on the collection information statement (CIS). This category includes things such as health insurance and child care.[3] When considering all expenses in this category, the IRS disallowed over 44 percent of the expenses even though the taxpayer was able to document the existence of the expense.

1 Internal Revenue Code (IRC) § 7122(d)(2)(B).

2 For example, see Internal Revenue Manual (IRM) 5.15.1.2(12), *Overview and Expectations* (Aug. 29, 2018).

3 The National Taxpayer Advocate previously made this recommendation. See National Taxpayer Advocate 2016 Annual Report to Congress 192-202.

Last, TAS Research looked at expenses that are not considered in the ALE calculation at all. These expenses include things such as retirement savings contributions and higher education expenses. The study did not find a high rate of reporting for these expenses; however, it could be that they were included in the "other expense" category. When considering only these expenses, the IRS disallowed the expense in over 43 percent of the cases reviewed. Of the disallowed expenses, the taxpayer provided substantiation of the expense in approximately 38 percent of the cases.

This analysis shows that the ALE standards as designed may not be sufficient. For instance, we question whether we should not see such a high degree of taxpayers reporting expenses in excess of the ALE standards. TAS Research has also documented that taxpayers are reporting expenses outside of what is allowed in the ALE standards. Some of these expenses are disallowed even when the taxpayer is already living below the maximum ALE amount calculated for his or her circumstances. When the ALE standards fail to reflect what it truly costs to meet necessary living expenses, some taxpayers will forego a basic living expense in order to pay a tax debt. Additionally, the IRS appears not to be exercising the amount of statutorily authorized flexibility to allow for deviations when necessary, as evidenced by the number of disallowances even when the taxpayer documented the expense.

#3 Do Taxpayers Respond to the Substantial Understatement Penalty? Analysis of Bunching Below the Substantial Understatement Penalty Threshold

The "economic deterrence" model of tax compliance suggests that higher or more certain penalties should produce more compliance. This study aims to explore the extent to which taxpayers respond to the substantial understatement penalty.

An accuracy-related penalty applies to various understatements, including "substantial" understatements and those due to negligence. If the understatement exceeds the substantial understatement threshold, a penalty applies even if the IRS does not determine the taxpayer was negligent. For individuals, the threshold is generally the greater of $5,000 or ten percent of the tax required to be shown on the return. The substantial understatement penalty should increase the likelihood that substantial understatements will be subject to an accuracy-related penalty. If it does, the deterrence model suggests that it should deter taxpayers from understating their tax liabilities by more than the substantial understatement threshold.

If the substantial understatement penalty affects compliance behavior, some taxpayers whose understatements would otherwise be just over the threshold should adjust their reporting so that their understatements are just below it. If they do, we should see the density of understatements concentrated or "bunching" at or just below it, and fewer (*i.e.*, a crater) just above the threshold.

To detect bunching at or below the threshold, we analyzed the distribution of individual examination assessments *(i.e.*, understatements) on returns selected at random as part of the National Research Program (NRP) for tax years (TY) 2006-2012 (excluding 2009). We reviewed histograms of the distribution of the understatements and applied statistical tests.

We did not detect significant evidence of bunching at or just below the substantial understatement penalty threshold for taxpayers overall or for any taxpayer segment. In other words, we did not find evidence that taxpayers respond to the economic incentive provided by the substantial understatement penalty, as predicted by the economic deterrence model of tax compliance.

#4 What Influence do IRS Audits Have on Taxpayer Attitudes and Perceptions? Evidence from a National Survey

This report presents results from a survey study of non-farm self-employed (Schedule C) taxpayers. The analysis explores how taxpayer attitudes and perceptions are shaped by different types of audits and audit outcomes. It also investigates whether certain groups of taxpayers share specific attitudinal postures towards paying taxes and the IRS and, if so, how audits influence membership within these groups.

To address these questions, the Taxpayer Advocate Service commissioned a survey of 2,729 Schedule C filers, including 1,363 taxpayers who experienced an audit of one of their returns filed for tax years 2010 through 2015 and 1,366 who did not. We find that many of the audited respondents do not recall the examination, and that the rate of recollection depends on both the type of audit that was conducted and the outcome of the examination. Overall, only 64 percent of audited Schedule C filers acknowledge having been audited. Audit recollection is especially poor among those who have experienced a correspondence audit (below 40 percent), which suggests that some taxpayers may not perceive correspondence examinations as actual audits. In the case of field and office examinations, a substantial majority of participants do remember being audited (72 percent and 80 percent, respectively), suggesting that face-to-face audits might have a stronger effect on taxpayer attitudes and behavior.

To account for additional determinants of audit awareness beyond audit type, we have performed a logit analysis that also includes audit outcome (positive tax adjustment, no tax change, or tax refund), measures of the recency of the examination, and indicators for an amended return and for paid tax return preparation as explanatory variables. The results indicate that taxpayers are relatively more likely to recall more recent audits as well as audits that result in a positive tax adjustment. All else being equal, respondents who experience an audit of an amended return are relatively less likely to recall the examination. It is standard practice at the IRS to review amended return filings and contact the taxpayer if any significant anomalies are identified, so taxpayers may tend to view an examination as a routine part of the amended return filing process rather than an actual audit, particularly if the examination is rather cursory.

To examine how audits influence taxpayer attitudes and perceptions, we have selected a matched unaudited "control group" from our survey sample with similar characteristics and a comparable audit risk to our sample of audited taxpayers. A comparison of the responses from our audit sample and matched control group reveals a mixed result with regard to the specific deterrent effect of an audit. On the one hand, audited taxpayers report a higher perceived level of audit risk than the control sample, suggesting that audits might be effective in discouraging future noncompliance. On the other hand, audited taxpayers perceive a relatively low level of sanctions for noncompliance, which runs counter to deterrence. Our analysis further indicates that audits tend to induce negative attitudes among audited taxpayers. Specifically, we find that audited taxpayers tend to perceive greater coercive power within the IRS, have relatively less trust in the agency, and express weaker sentiments with regard to voluntary compliance than the matched control sample. Audited taxpayers are also relatively more likely to indicate that paying taxes feels like something is taken away from them, rather than as a contribution to society.

Our results demonstrate that the nature of the examination process has important implications for taxpayer perceptions of fairness. Overall, correspondence audits tend to be more impersonal than face-to-face examinations, and they tend to focus more narrowly on one or two specific reporting issues on the return. Typically, individuals who have experienced a field or office audit report a greater sense of fairness in the examination process than those who have experienced a correspondence examination.

The impact of audits on taxpayer attitudes and perceptions is also found to vary with the outcome of the examination. Taxpayers who have received an additional tax assessment as a result of the audit report a higher perceived risk of future audits and a weaker sense of procedural and distributive justice than those who received a tax refund or no adjustment. At the same time, taxpayers who have received an additional tax assessment tend to express lower levels of trust in the IRS, a greater sense of coercion, and stronger feelings of anger and threat. Overall, then, it appears that the deterrent effect of an audit is likely to depend on the outcome of the examination.

Finally, we investigate whether certain groups of taxpayers share a common attitudinal posture towards paying taxes and the IRS and, if so, how audits impact the composition of these groups. Our analyses of survey responses within our matched sample suggest that self-employed taxpayers can be constructively divided into three groups in accordance with their attitudes towards paying taxes, motivations to comply, trust in, and negative emotions towards the IRS.

The first group holds positive attitudes towards the IRS and views paying taxes as a contribution to society. It perceives the IRS as trustworthy, feels protected against free riders, and reports an absence of negative emotions towards the IRS. The second group holds reasonably neutral attitudes towards the IRS. While members of this group view paying taxes as a contribution to society, they possess only a limited degree of trust in the IRS and report moderate levels of negative emotions towards the Agency, such as anger and fear. The third group holds negative attitudes towards the IRS. More specifically, this group reports that paying taxes feels like something is taken away from them. Its members report low levels of trust in the IRS, and they express strong negative emotions, especially anger, towards the Agency.

When investigating the effect of audits on the relative shares of these three groups within each audit type and outcome category, we find a larger share of taxpayers who hold negative views towards the IRS among individuals who have experienced a correspondence audit. This supports the finding that face-to-face audits have a more positive effect on taxpayer attitudes and perceptions than correspondence audits. The membership share for the group with the most negative attitudes towards the IRS is largest among those who received an additional tax assessment as a result of the audit. On the other hand, the membership share for the group with the most positive attitudes is highest among those who experienced no change in their tax status – even higher than that observed for taxpayers who have received a tax refund as a result of the audit. Perhaps this is an indication that taxpayers who received a tax refund as a result of the audit tend to feel somewhat frustrated that they were forced to undergo an audit despite having overpaid their tax obligation. Alternatively, perhaps they are relatively more likely to perceive their selection for audit as a sign of undeserved mistrust by the IRS than those who experienced no tax change as a result of the examination.

Our findings demonstrate that IRS audits have the potential to change taxpayer attitudes in both positive and negative ways. While many taxpayers fail to recall a correspondence audit experience, such audits are nonetheless perceived to be less fair than face-to-face examinations, suggesting that field and office audits might be better suited to deter evasion. Moreover, the audit outcome seems to affect the perceived risk of future examinations: taxpayers who have experienced a positive tax adjustment perceive a higher audit risk than those who have received a refund or no tax change. This result complements the earlier finding by the Taxpayer Advocate Service (Beer, Kasper, Kirchler, & Erard, 2015) that the behavioral response to an audit is highly dependent on the audit outcome.

#5 A Study of the IRS Offer in Compromise Program for Business Taxpayers

An offer in compromise (OIC) is an agreement between a taxpayer and the government that settles a tax liability for payment of less than the full amount owed. The IRS has authority to accept offers pursuant to Internal Revenue Code (IRC) § 7122. TAS Research conducted this analysis to study how business taxpayers (Business Master File (BMF)) use the Offer in Compromise (OIC) program and the impact of the OIC program on future compliance of business taxpayers. For the purposes of this study, "BMF taxpayer" is defined as a taxpayer who filed a Form 941, *Employer's Quarterly Federal Tax Return*, and then either a Form 1065, *U.S. Return of Partnership Income*, Form 1120, *U.S. Corporation Income Tax Return*, Form 1120S, *U.S. Income Tax Return for S Corporation*, or a Schedule C, *Profit or Loss From Business (Sole Proprietorship)*.

To study the impact of the OIC program, TAS Research examined taxpayers' filing and payment compliance subsequent to an accepted OIC. BMF taxpayers with accepted OICs are about half as likely to become noncompliant in filing or paying their future BMF tax obligations for five years after the IRS accepts the OIC than BMF taxpayers whose OICs were not accepted. When considering only those BMF taxpayers who continued to operate, the difference in subsequent filing and payment compliance rates were more pronounced. Approximately 91 percent of BMF taxpayers with an accepted OIC were in filing compliance beyond five years after the OIC consideration compared to 82 percent of BMF taxpayers without an accepted OIC.

TAS Research also analyzed the number of taxpayers who submit multiple OICs within 180 days, referred to as "churning." Between 2007 and 2016, between approximately four percent and nine percent of taxpayers submitting an OIC had an incident of "churning" with an accepted OIC in approximately 36 percent to 76 percent of the cases. This indicates that business taxpayers are trying to submit successful OICs even if it sometimes takes multiple attempts.

TAS Research looked at how the amount offered on returned or rejected OICs compares to what the IRS has actually been able to collect. TAS Research found that nearly 40 percent of rejected or returned OICs had an amount offered that was greater than the amount collected. In fact, the average amount offered for this population of OICs was more than two times the average amount ultimately collected, and the median amount offered was more than five times the median amount collected.

For rejected OICs in particular, TAS Research looked at what the IRS determined to be the Reasonable Collection Potential (RCP), which is the calculation of all of the taxpayer's assets, income, and liabilities. Depending on the business entity type, TAS Research found that the RCP is about seven to ten times greater than the amount offered and 20 to 30 times what has been collected subsequently. By rejecting these OICs, the IRS not only loses an opportunity to collect revenue, but it misses out on the improved compliance effect that comes with accepted OICs.

#6 Further Analyses of "Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens and Alternative IRS Letters on Individual Tax Debt Resolution"

A federal tax lien (FTL) arises when the IRS assesses a tax liability and sends the taxpayer notice and demand for payment, and the taxpayer does not fully pay the debt within ten days. However, an FTL is not sufficient to protect the government's interest in the taxpayer's assets against other creditors. To establish its interest in property with respect to other competing interests, the IRS must file a Notice of Federal Tax Lien (NFTL). NFTLs establish priority of the government's interest in a taxpayer's property with respect to certain creditors by putting the public, including third-party creditors, on notice of an existing statutory lien. In the past, the IRS generally filed an NFTL on all unresolved cases with unpaid balance of assessment of over $10,000 before transferring the case from its Automated Collection System (ACS) to the collection queue. In 2011, the IRS began its Fresh Start initiative and suspended the routine filing of an NFTL on ACS unresolved cases before the cases were transferred to the collection queue, unless the unpaid balance of the assessments was over $25,000. However, a 2014 report issued by the Treasury Inspector General for Tax Administration (TIGTA) recommended the IRS begin filing an NFTL on tax liabilities with unpaid assessments of over $10,000.

The National Taxpayer Advocate persuaded the IRS to conduct a study to determine if the NFTL or one of three alternative collection letters were more effective in reducing the balances owed by taxpayers. The IRS selected a random sample of about 13,000 taxpayers who generally owed between $10,000 and $25,000, dividing the sample taxpayers into five groups, a group receiving an NFTL, three groups receiving one of three alternative collection letters requesting payment of the balance, emphasizing collection alternatives, and providing information where the taxpayer could receive additional assistance, in addition to a control group. TAS was primarily responsible for creating the three alternative collection letters, while IRS Research, Applied Analytics, and Statistics (RAAS) performed most of the initial analyses and drafted the study report. The study, which will be published in an upcoming IRS Research Bulletin, determined that the sample group receiving the NFTL saw the greatest reduction in the balance owed for both the year immediately after treatment and the combined two-year period subsequent to treatment. Nevertheless, TAS believes there are some additional findings from the study data that should be highlighted to help inform IRS policy on when to file an NFTL. These items are summarized hereafter.

- About 93 percent of the dollars collected in the five groups are from taxpayers where an analysis of systemic data indicates the taxpayers' income exceed their allowable living expenses (ALE) or the taxpayer possesses an asset, which could possibly be used to satisfy all or part of the balance due. TAS believes the IRS can construct a filter to determine when the IRS should routinely file an NFTL.
- The alternative collection letters induce as many or even more taxpayers to make payments as the NFTL, even though the NFTL generally results in a greater reduction in the balance due. Because of this fact, the IRS needs to consider whether its messaging in other collection notices should be designed to elicit money from taxpayers likely unable to afford these payments.
- The monthly alternative collection letter generated a greater reduction in the balance due during the second year after taxpayers received the letter than during the second year after the taxpayer received the NFTL. Overall, the monthly letter was the next most effective treatment. Monitoring the test cases over the next several years will help determine if the reduction in the balance due continues to decrease beyond two years after the IRS filed the NFTL, and if at the same time, the reduction in the balance due continues to increase for those receiving the monthly alternative collection letter.

- Taxpayers receiving the NFTL are less likely to have a TDA than any of the three groups who received an alternative collection letter, although the difference is only statistically significant for the first alternative collection letter (Letter 5696C). Taxpayers in the group receiving the NFTL were more likely to have an unfiled return for the year after the treatment occurred, but the difference was not statistically significant. All of the treatment groups were less likely than the control group to have a TDI for the next income tax return due after treatment; however, the difference to the control group was not statistically significant at the 95 percent confidence level.
- Taxpayers receiving the NFTL are less likely to have a TDA than any of the three groups who received an alternative collection letter, although the difference is only statistically significant for the first alternative collection letter (Letter 5696C). Taxpayers in the group receiving the NFTL were more likely to have an unfiled return for the year after the treatment occurred, but the difference was not statistically significant. All of the treatment groups were less likely than the control group to have a TDI for the next income tax return due after treatment; however, the difference to the control group was not statistically significant at the 95 percent confidence level.

TAS concurs with the study finding that an NFTL is generally the most effective at reducing the balance due, when compared to other alternative collection letters. However, TAS also believes that the IRS should consider a taxpayer's facts and circumstances before deciding to file an NFTL. Furthermore, the data indicate that the IRS can use systemic data to determine with a high probability, which taxpayers have the wherewithal to pay towards the liability, indicating the filing of an NFTL may be an effective course of action. Nevertheless, routinely filing the NFTL in only those cases where the taxpayer appears to have the ability to pay toward the liability (but has not done so) will reduce what the IRS pays in fees to file the NFTL, while reducing burden for those taxpayers without a current likely ability to pay towards their liability.

LITERATURE REVIEW

#1 Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights

Notices are an important way in which the IRS communicates with taxpayers to inform them of their rights and obligations. The National Taxpayer Advocate has expressed concerns that IRS notices need well-researched makeovers to ensure that they reflect how taxpayers best perceive and comprehend written information. IRS notices frequently include unnecessary information or follow a confusing structure that prevents taxpayers from adequately understanding what they are required to do. In this Literature Review, TAS examined psychology, cognitive science, and behavioral science research to identify best practices for communication through notices. The insights gained from this research, coupled with using plain language, can help the IRS identify ways it can alter its notices to improve taxpayer understanding of 1) why the IRS is reaching out to a taxpayer; 2) what is the most important information in the notice; and 3) how a taxpayer can exercise his or her rights. With consideration of the key insights identified in this Literature Review, such as simplification of the message, effective organization, using the behavioral tool of nudging to steer taxpayers in a particular direction, focusing on personalizing the message, or even changing the typography design, the IRS can redesign its notices to improve clarity and taxpayer understanding.

NATIONAL TAXPAYER ADVOCATE 2019 PURPLE BOOK: Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration

The National Taxpayer Advocate Purple Book presents a concise summary of 58 legislative recommendations intended to strengthen taxpayer rights and improve tax administration. Most of the recommendations presented in the Purple Book have been made in detail in our prior reports, but others are presented in this report for the first time.

In last year's Purple Book, we made 50 legislative recommendations. One—a proposal to hold taxpayers harmless when the IRS improperly levies on a retirement account—was enacted into law. At least 20 others were included in comprehensive tax administration bills—notably, H.R. 5444, the Taxpayer First Act, which the House passed on a vote of 414-0; S. 3246, also known as the Taxpayer First Act, which was co-sponsored by Senate Finance Committee Chairman Hatch and Ranking Member Wyden; and S. 3278, the Protecting Taxpayers Act, which was introduced by Senator Portman and Senator Cardin, who two decades ago were the House sponsors of the landmark IRS Restructuring and Reform Act of 1998.

The Purple Book is designed to assist the tax-writing committees and Members of Congress by identifying legislative changes we believe would better protect taxpayer rights and improve tax administration. We have aimed to make it as user friendly as possible. Each proposal is presented in a format similar to the one used for congressional committee reports, with "Present Law," "Reasons for Change," and "Recommendation(s)" sections.

At the end of each proposal, we identify bills that have been introduced in the House or Senate that are our consistent with it. In a separate chart, we list additional reference material to assist those interested in learning more about a recommendation. Thus, we identify prior legislative language so that a Member of Congress interested in sponsoring similar legislation can use or refine existing language rather than having to reinvent the wheel.

It has now been more than 20 years since the enactment of the IRS Restructuring and Reform Act of 1998, and over that period, we have had ample time to assess the impact of its provisions. Most changes have stood the test of time well, but some require tweaking. In addition, tax administration has changed in many ways, partly due to the increasing use of automation by the IRS and the increasing use of the internet and other digital services by taxpayers.

For these reasons, we are very much encouraged by the congressional interest in examining the current state of tax administration and developing legislation to improve it. We believe most of the recommendations presented in the Purple Book are non-controversial, common sense reforms that will strengthen taxpayer rights and improve tax administration. We hope that Members of Congress and their staffs find this compilation useful.

TAXPAYER ADVOCATE SERVICE

YOUR VOICE AT THE IRS

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